OMB CIRCULAR A-76

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

OF THE

COMMITTEE ON VETERANS' AFFAIRS HOUSE OF REPRESENTATIVES

NINETY-SEVENTH CONGRESS

FIRST SESSION

NOVEMBER 17, 1981

Serial No. 97-47

Printed for the use of the Committee on Veterans' Affairs

U.S. GOVERNMENT PRINTING OFFICE

88-212 O WASHINGTON : 1982

H761-9

COMMITTEE ON VETERANS' AFFAIRS

G. V. (SONNY) MONTGOMERY, Mississippi, *Chairman*

DON EDWARDS, California
GEORGE E. DANIELSON, California
JACK BRINKLEY, Georgia
RONALD M. MOTTL, Ohio
ROBERT W. EDGAR, Pennsylvania
SAM B. HALL, JR., Texas
DOUGLAS APPLEGATE, Ohio
MARVIN LEATH, Texas
WILLIAM HILL BONER, Tennessee
RICHARD C. SHELBY, Alabama
DAN MICA, Florida
THOMAS A. DASCHLE, South Dakota
BOB STUMP, Arizona
PHIL GRAMM, Texas
AUSTIN J. MURPHY, Pennsylvania
BYRON L. DORGAN, North Dakota
ANTONIO B. WON PAT, Guam
JOHN PAUL HAMMERSCHMIDT, Arkansas
MARGARET M. HECKLER, Massachusetts
CHALMERS P. WYLIE, Ohio
ELWOOD HILLIS, Indiana
HAROLD S. SAWYER, Michigan
GERALD B. SOLOMON, New York
JIM JEFFRIES, Kansas
BOB McEWEN, Ohio
JIM DUNN, Michigan
CHRIS H. SMITH, New Jersey
ALBERT LEE SMITH, Alabama
DENNY SMITH, Oregon
MARK D. SILJANDER, Michigan

MACK G. FLEMING, *Chief Counsel and Staff Director*

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

G. V. (SONNY) MONTGOMERY, Mississippi, *Chairman*

GEORGE E. DANIELSON, California
BOB STUMP, Arizona
SAM B. HALL, JR., Texas
DAN MICA, Florida
MARVIN LEATH, Texas
ANTONIO B. WON PAT, Guam
ELWOOD HILLIS, Indiana
JOHN PAUL HAMMERSCHMIDT, Arkansas
HAROLD S. SAWYER, Michigan
GERALD B. SOLOMON, New York
JIM JEFFRIES, Kansas

CONTENTS

NOVEMBER 17, 1981

Page

OMB Circular A-76 1

STATEMENTS BY COMMITTEE MEMBERS

Opening statement of Hon. George E. Danielson 1
Solomon, Hon. Gerald B 2

WITNESSES

Gilroy, Robert M., Senior Associate Director, Logistics and Readiness Division, GAO 3
Prepared statement of Mr. Gilroy 31
Schafer, Dr. Paul W., executive director, National Association of VA Physicians 7
Prepared statement of Dr. Schafer 46
Pollard, C. William, president and chief operating officer, Servicemaster Industries, Inc., accompanied by Roger Erwin, Servicemaster Industries, Inc 10
Prepared statement of Mr. Pollard 50
Kalpin, Raymond, president, Harry A. Stroh Associates 18
Prepared statement of Mr. Kalpin 58
Netterstrom, James, president-elect, Building Service Contractors Association International, accompanied by Alfred Bromberg, director of marketing, Crothall Hospital Services 19

MATERIAL SUBMITTED FOR THE RECORD

Statements:
National Federation of Federal Employees 61
Richardson, Russell W., chairman, Committee on Contracting Out (CoCo) .. 67
Chamber of Commerce of the United States of America 91
U.S. Chamber Health Care Committee, "Competition in Health Care," October 2, 1981 95
Chamber of Commerce of the United States of America, "Government Competition," August 27, 1981 108
Written questions and answers:
Hon. G. V. Montgomery to GAO 43

OMB CIRCULAR A-76

TUESDAY, NOVEMBER 17, 1981

HOUSE OF REPRESENTATIVES,
COMMITTEE ON VETERANS AFFAIRS,
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS,
Washington, D.C.

The subcommittee met, pursuant to notice at 8:30 a.m., in room 334, Cannon House Office Building, Hon. G. V. (Sonny) Montgomery (chairman of the subcommittee) presiding.

Present: Representatives Montgomery, Danielson, Leath, Won Pat, Solomon, and Jeffries.

OPENING STATEMENT OF HON. GEORGE E. DANIELSON

Mr. DANIELSON. The subcommittee will come to order. I will be chairing the hearing in Mr. Montgomery's absence. Mr. Montgomery will arrive shortly, I am told.

This is an oversight hearing on the Office of Management and Budget Circular A-76, policies for acquiring commercial or industrial products and services needed by the Government.

As you know, our first hearing was held on July 14 and we heard testimony from the Veterans' Administration, OMB, the American Federation of Government Employees, a former VA Hospital Director, and representatives of veterans organizations.

Serious questions about the scope and intent of Circular A-76 were raised during that hearing. Those questions and the revelation of the enormous costs in completing the cost comparison studies required by Circular A-76 prompted the chairman to schedule a full committee hearing on this subject. That hearing was held on October 20 and we received testimony from interested members of Congress, the Veterans' Administration, the Office of Management and Budget, VA hospital management personnel, private hospital directors, and the American Federation of Government Employees.

It was learned during that hearing that the Veterans' Administration had stopped conducting the A-76 cost comparison studies as a result of Public Law 97-66, which contains language forbidding the use of funds of Veterans' Administration medical care accounts for conducting those studies. We remain steadfast in our belief that such funds should not come from the medical budget but should be requested in a separate appropriation.

We also learned that OMB has agreed with the former Veterans' Administration General Counsel's legal opinion that contracting out direct patient care is precluded by law and therefore must be performed by Government personnel. We were pleased to learn of this because we do not want the health care of the veteran to be compromised.

Today we will receive testimony from Mr. Robert M. Gilroy, Senior Associate Director of the General Accounting Office's Procurement, Logistics, and Readiness Division. The General Accounting Office has been actively involved in contracting out studies throughout the Federal Government and we are anxious to learn of any developments in their studies.

Also testifying will be Dr. Paul W. Schafer, executive director of the National Association of Veterans' Administration Physicians, who will present his association's views on the effects of contracting out on patient care. We will also hear from several service contracting companies and associations which are interested in contracting under Circular A-76.

Leading these witnesses will be Mr. C. William Pollard, president and chief operating officer of ServiceMaster Industries, Inc., and as an aside, I will comment that one of my good friends, a former colleague from California, is with that group.

He will be followed by a panel consisting of Mr. Raymond D. Kalpin, president of Harry A. Stroh Associates, Inc., Mr. James S. Netterstrom, president-elect of the Building Service Contractors Association, International, and Mr. Alfred Bromberg, director of marketing, Crothall Hospital Services of Freehold, N.J.

At this time I will recognize the distinguished ranking minority member of the subcommittee, Mr. Bud Hillis of Indiana, and note his absence.

As noted earlier, our first witness will be Mr. Robert M. Gilroy of the General Accounting Office. Mr. Gilroy, are you in place? Please come up and be seated before the microphones. If you have someone with you whom you need as support, please bring them with you.

Mr. SOLOMON. Mr. Chairman?

Mr. DANIELSON. Mr. Solomon, in a moment you'll be recognized in lieu of Mr. Hillis. Is that a deal?

Mr. SOLOMON. I have a statement on behalf of Mr. Hillis.

Mr. DANIELSON. I think that's excellent. Just a moment and we'll come right to you. As noted earlier, Mr. Gilroy of the GAO will be our first witness. I'm going to ask that you, Mr. Gilroy, and all other witnesses summarize your testimony in not to exceed 10 minutes. Your complete prepared statement will be made a part of the record.

And now it's my distinct pleasure to yield to Mr. Solomon of New York, who will speak on behalf of Mr. Hillis.

STATEMENT OF HON. GERALD B. SOLOMON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. SOLOMON. Thank you, Mr. Chairman, and Mr. Hillis will be here. He's detained at another meeting. But on his behalf and mine I'd like to say I'm grateful to the witnesses who have agreed to appear before the subcommittee today to enlighten us further on the implications of contracting out some services now performed by federal employees in Veterans' Administration hospitals.

All of us can probably agree that the stated objectives of OMB Circular A-76 are commendable. Namely, the services should be considered for contract when it is clearly in the best interest of the

Government and when the function to be performed is not inherently governmental in nature.

These terms may be easier to define in other agencies but I find it somewhat difficult to isolate any activity that takes place within a VA hospital as being nongovernmental.

It also has been argued that the activities involved in operating a hospital are often so interrelated as to be inseparable. I would hope that the witnesses would touch on this subject and we are all interested in cost control and cost reduction and certainly I am not opposed to profits and the profit motive in the production of goods and services, so we appreciate your coming here and we look forward to your testimony.

Thank you, Mr. Chairman.

Mr. DANIELSON. Thank you, Mr. Solomon. Mr. Gilroy, the floor is yours for not to exceed a 10-minute oral presentation.

STATEMENT OF ROBERT M. GILROY, SENIOR ASSOCIATE DIRECTOR, PROCUREMENT, LOGISTICS AND READINESS DIVISION, GAO, ACCOMPANIED BY JOHN RINKE, GROUP DIRECTOR: AND WARREN NAGEL, ASSIGNMENT MANAGER

Mr. GILROY. Thank you, Mr. Chairman. As you suggest, I will read an abbreviated statement.

First I'd like to introduce my associates. On my right is Mr. John Rinko who is a group director from our Procurement, Logistics and Readiness Division and who is in charge of contract management work.

Mr. DANIELSON. We're very happy to have him here.

Mr. GILROY. On my left is Warren Nagel, also of the Procurement, Logistics and Readiness Division, who is our assignment manager for A–76 work.

Mr. DANIELSON. Fine. Would you pull the microphone a little bit closer to you? Thank you, and you may proceed.

Mr. GILROY. Mr. Chairman and members of the subcommittee, we are here at your request to assist you in your oversight review of Office of Management and Budget [OMB] Circular A-76. It is our understanding that the subcommittee is interested in any new information we may have on the current status of OMB Circular A–76 cost comparison studies within the Veterans' Administration [VA] and its Department of Medicine and Surgery.

Because GAO has not done any work at VA regarding Circular A–76, the subcommittee has requested GAO to cite examples of reviews it has made at other agencies, and the results obtained, in two related areas of interest. These areas concern the implementation of Circular A–76 and the adequacy of agency actions to ensure good contractor performance of A–76-type activities.

The Department of Defense has devoted considerable time and effort over the years to implement the A–76 policy. Consequently, most of our reports concern that agency. These reports involve a wide assortment of functions, ranging from individual types of services to total installation support for a number of services.

Generally, our more recent reviews concerning the circular's implementation have involved either, one, an evaluation of the propriety of a specific contracting-out decision at a given location

or, two, a more comprehensive evaluation of an agency-wide or Government-wide nature.

Our work in the first category is almost exclusively the result of constituency requests from individual Members of the Congress and generally involve a detailed evaluation of an agency-prepared cost comparison. Several examples of this type of work are as follows: In one review we estimated a substantially higher savings than the Air Force primarily because it had understated the number of in-house employees needed.

In another review, we estimated a reduced savings by contracting out because the Army overstated the number of cooks needed in dining facilities.

Our more comprehensive evaluations are typically reviews of broad issues surrounding the A-76 program or reviews of major functions of a commercial or industrial nature.

A few examples of this type of work are as follows: In a review of 12 conversions, we found that the most significant reason for contracting out was that contractor costs were lower than in-house costs.

In a review of 18 conversions, we found that most of the conversions did not result in performance shortfall, but we did find unsatisfactory contractor performance was experienced in five cases, and one conversion was based on an incomplete statement of work. In those cases where contract price increases occurred, they seemed to be justified.

Agencies should take several important actions, both before and after a contract is awarded to better insure good contractor performance of an A-76-type activity.

I would like to address now some recent reviews which have primarily focused on the adequacies of contract administration—what is done to insure that the Government gets what it pays for and that work set out in contracts is actually performed.

These reviews, therefore, were not started because of considerations involving Circular A-76, but to evaluate the adequacy of contract administration. A few examples of this type work are as follows: At 10 military installations we visited, we found that contract administration was not adequate to prevent intentional or unintentional overcharges on contracts for real property maintenance, repair, and minor construction. DOD conceded that the deficiencies were, in general, a result of a failure to follow existing policy and guidelines.

In a review of food service contracts at 17 military installations, we found that the contract administration system for assuring satisfactory contractor performance lacked uniformity and was ineffective. DOD concurred, in general, with our recommendations and indicated corrective actions have been initiated.

In our review of military contractor-operated parts stores and contractor-operated civil engineering supply stores, we found that these contracts are unsound, unmanageable, and expose the Government to potential fraud and abuse. The unsound buying practices and abuses we found were traceable to defects in the contracts and breakdowns in internal control. We recommended that the DOD explore other means to buy these supplies. Government-oper-

ated stores purchasing from local commercial wholesale distributors at prevailing market prices is an alternative.

In closing, we would like to say that although its implementing guidelines could be strengthened, GAO supports the general policy precepts set forth by Circular A-76. These precepts are: One, Government reliance on the private sector is a valid principle; two, certain functions are inherently governmental in nature and must be performed in-house; and three, the taxpayer is entitled to economy in Government and cost comparisons are appropriate as criteria.

In 1978 we recommended, as did the Commission on Government Procurement in 1972, that the Congress establish a national policy relating to reliance by the Federal Government on the private sector to provide needed goods and services. Without a firm national policy the future of the A-76 program will be a repetition of the past—confusion, controversy, and ineffective implementation. The policy must be stable and must appropriately balance many issues of national significance. It needs both legislative and executive branch endorsement and support.

I'll be happy to respond to any questions you may have at this time.

[The prepared statement of Mr. Gilroy appears on p. 31.]

Mr. DANIELSON. Thank you very much, Mr. Gilroy. You made an excellent presentation and your entire statement will be in the record, as I previously stated.

I am pleased to yield first to Mr. Solomon of New York for such inquiry as he may wish to make.

Mr. SOLOMON. Mr. Chairman, I don't have any inquiries right now. Are the gentlemen going to stay through the course of the testimony?

Mr. DANIELSON. Well, I'm going to have to pass that question on to the gentlemen.

Mr. GILROY. If you so request, we will, sir.

Mr. SOLOMON. Well, it's not necessary but we may have some questions.

Mr. DANIELSON. I have just received a note which is apropros of what you just said. Chairman Montgomery, who will be here quite shortly—I think he's attending a prayer meeting this morning—but when he's completed his devotions he intends to come and he would like to have a chance to interrogate at that time. He'll be here very shortly.

Mr. GILROY. Fine.

Mr. DANIELSON. Mr. Gilroy, I have but one subject area of question. I'd like your response. I feel throughout your presentation, in fact, throughout this—the two previous hearings as well as today, that we're trying to come to some kind of an understanding on whether or not contracted services fill the Government's needs as well as in-house services, and I can't avoid a conclusion that you stated in your final remarks, that there's a blend, there's a mixture. In some instances we need in-house and in some instances we need private suppliers.

I find this problem in related fields here in the Government. The business of government is enormous in size. It's complex. It has almost infinite variety. Operating, carrying out all these operations

within the Government structure itself, is difficult because we don't seem to be able to apply a strict enough supervisory management control on everything that takes place. So, in order to relieve ourselves of the burden and the guilt feelings which come with knowing that we're not doing our job adequately, we contract these services out. Then we find that having relieved ourselves of the burden we again fail to supervise adequately. We fail to set up adequate standards and, again, the taxpayer pays an unnecessary bill and sometimes the services are not up to par. Am I far from right on that?

Mr. GILROY. Well, sir, I believe there are many reasons for contracting out and I would guess the one reason you stated may be a motivating factor. We have found that there are savings by contracting out. The greatest potential for savings by contracting out are for those type activities where competition exists in the private sector, that is, the commercial and industrial-type activities. We also believe there are inherent Government functions which should remain in the Government—the policymaking-type functions.

Mr. DANIELSON. As to the services themselves, do you find that there is a fluctuating level of need so that on one occasion contracting out for services requires a certain magnitude of contract and numbers of persons to be involved, but with a rising and falling level of need you sometimes are overcontracted and maybe sometimes undercontracted, for that matter, whereas in-house you're more able to shift personnel and accommodate to the rise and fall of need? Is there any validity in that?

Mr. GILROY. One thing we found in our contract administration work which is, we believe, a good rule of thumb, is that you shouldn't contract out that which you can't properly administer. Now, we have found instances, as we mentioned in the testimony, where we have encountered some of those type contracts. It became a nightmare for agencies in trying to administer the contract. We feel in those instances if you applied the rule I previously mentioned, you would be better off keeping the operation in-house.

Mr. DANIELSON. I certainly thank you for your answers. I think part of our problem is the magnitude of Government and the detail involved and is there any way that mere mortals can handle this problem.

I am honored to yield to my chairman, Sonny Montgomery, G. V. Montgomery, of Mississippi, who is now here to take over and run this committee as it should be run.

Mr. MONTGOMERY. Thank you. I appreciate the gentleman from California, Mr. Danielson, chairing this morning. It certainly helped me out. I'd like to ask our witnesses from the General Accounting Office, would you mind staying around some this morning? We hope to have this committee meeting over not too late in the morning, and this would help us if we had some other questions.

Mr. GILROY. We'd be happy to stay, sir.

Mr. MONTGOMERY. Thank you very much, and we appreciate your being here. We will include your complete remarks in the

record. In addition, the committee will submit written questions to GAO.[1]

Our next witness is Dr. Paul Schafer, the executive director of the National Association for the Veterans' Administration Physicians.

Dr. Schafer, without objection, your testimony will be put in the record, and if you'd like to summarize, we'd certainly like to hear from you now.

STATEMENT OF DR. PAUL W. SCHAFER, EXECUTIVE DIRECTOR, NATIONAL ASSOCIATION OF VA PHYSICIANS

Dr. SCHAFER. Thank you very much, Mr. Chairman. Members of the committee, my name is Paul Schafer and I appear before you on behalf of the National Association of Veterans' Administration Physicians. I thank you for this opportunity to express our members' grave concern about OMB Circular A-76.

I'm a physician, a surgeon, and I speak here today in a strictly unofficial capacity as executive director of NAVAP. I serve at the local Veterans' Administration medical center as chief of thoracic surgery and chief of electron microscopy. My current academic affiliation is as professor of surgery at Georgetown University.

The National Association of VA Physicians is the largest single professional organization representing the more than 10,000 full and part-time, salaried physicians employed by the Veterans' Administration. Though ours is a young organization, many of our members have long service in and much knowledge of the VA health care delivery system.

We were appalled by the Federal Register of July 29. There on pages 38842 through 38866 we, for the first time, without warning, saw the planned review schedules, part of the agency's efforts to implement A-76 in our 172 hospitals and medical centers. On inquiry, we were given naive assurances that none of the activities proposed for contracting out were directly concerned with the delivery of first quality health care to sick and injured veterans.

In my prepared testimony I enumerated the 36 functions that were identified for review at one of our tertiary medical centers. That happened to be at Decatur or Atlanta, Ga.

I do not intend to tell you that none of these should be exempt from such considerations. Maybe we should contract some ground maintenance functions, perhaps some aspects of security. It should certainly not be overlooked that the VA has regularly contracted out nearly half of its plant maintenance, repairs, and operations. The irrelegious might question even the need for chaplains, and who knows about such things as medical library and audiovisual activities.

The areas about which we are most concerned are those vital services which so closely support and are so intimately integrated into the major bed services of internal medicine, surgery, psychiatry, and neurology. Medical records and dietetics are such examples. A patient's management is sorely compromised if a complete and accurate record of prior medical events is not made promptly available to guide current treatment. Prescription dietary functions

---

[1] See p. 43.

for seriously ill patients obviously require the closest possible therapeutic integration.

Though not directly treated now in the proposed review, there are other existing contract experiences that should serve us as warning. We know of RFP's resulting in multimillion dollar contracts where noncompliance is not only overlooked but is made the basis for major additional payments.

Full-time VA physicians have been pressured into private sector identification so that mercenary interests could contract for their proprietary service. Scarce medical specialties like anesthesiology are really fair game with the result that contractors staff a tertiary VA medical center with nurse anesthetists instead of physician anesthesiologists.

The first short term of a radiology service contract can look very attractive but what are the second and third time around like after all the VA people are gone? The contractor then writes his own ticket.

We sincerely believe that the VA health care delivery system is a national treasure that delivers a work product, namely, good medical care, for its sick and injured veterans at a cost that cannot even be remotely matched by any segment of the private sector. Beyond that, with the lessons of the air traffic controllers in mind, it should not be overlooked that contractor employees will surely become targets for union organization and they can strike.

Don't discount the disruptions that follow contractor bankruptcies and lesser business reverses. In these times of economic travail, what of the sheer number of dollars involved? Dr. Azar, chief of the laboratory service at the Minneapolis VA Medical Center has an annual budget for his service of about $4 million. Were the procedures that his service performs to be contracted out to the private sector in that community they would cost $40 million per year. This is essentially the annual budget for the entire Minneapolis Veterans' Administration Medical Center.

In conclusion, I do not wish to leave the impression that the VA cannot improve its delivery of health care to veterans and that it cannot become increasingly efficient in so doing, but what I do suggest to you is that even now veterans have a very good medical program, costing the nation only a fraction of what that service would be billed by the private medical sector.

Thank you.

[The prepared statement of Dr. Schafer appears on p. 46.]

Mr. MONTGOMERY. Thank you, Dr. Schafer and for the members of the committee, Dr. Schafer is a nationally known surgeon. We're very flattered that he works with the Veterans' Administration and that we have terrifically qualified people in the medical profession working for the VA and as the chairman of this committee I thank you for the wonderful service you've given the veterans over the years.

Mr. Danielson?

Mr. DANIELSON. I just want to say thank you, Dr. Schafer, for your presentation. I firmly feel that all through these hearings, Mr. Chairman, we're coming to the confrontation between are we running a Government or are we running a business, and I don't think that everything in Government is a business. That's my

personal opinion. Sorting them out into their respective categories is our problem, and your testimony, Dr. Schafer, is of great help to me anyway.

Dr. SCHAFER. Thank you, sir.

Mr. MONTGOMERY. Mr. Solomon?

Mr. SOLOMON. I just want to thank the doctor for taking the time to come here too and in your testimony you mentioned that the VA has regularly contracted out nearly half of its plant maintenance, repairs, and operations. Is that a particular hospital, when you say the VA has regularly done this?

Dr. SCHAFER. No, I made that comment in respect to the whole agency, and, of course, I do have personal experience of seeing what is contracted out in our own medical center. We almost never embark, in our medical center, on anything of any substance. It almost always becomes a matter that is contracted out. But to be very specific in regard to that reference, that was the testimony of Mr. Cook in regard to, I believe it was, the second of the hearings that you have held on this matter. So, I could not speak for the whole agency but I felt he could.

Mr. SOLOMON. The point I was leading up to was even absent the implementation of Circular A-76, the VA already has the authority in individual placements, your hospital, others, for nongovernmental contracting out, such as repairs and maintenance and things of that nature.

Dr. SCHAFER. Right.

Mr. SOLOMON. In other words, it's up to the discretion of that particular hospital. Is there a list of things that you are allowed to contract out now other than what you've just mentioned here? Are there other examples?

Dr. SCHAFER. I'm not aware of any such list but what happens is out of necessity this occurs, because we are not sufficiently staffed to do many of the things that are required to maintain a properly functioning organization, so that I think we have no alternative. But I know of no such list, sir.

Mr. SOLOMON. But the hospital administrator does have the authority now to contract out in certain instances where he thinks it's necessary?

Dr. SCHAFER. That is my understanding.

Mr. SOLOMON. Thank you very much.

Mr. MONTGOMERY. The gentleman brings up a point. Just for the record I'd like to say under title 38 it says the Administrator of the Veterans' Administration has the authority to contract out for most areas of running the hospital and then, as I understand it, the Administrator gives the authority to the director of these hospitals to use his or her discretion in contracting out. Doctor, we are contracting out for medical services now. I know radiologists are in a shortage in the Veterans' Administration and we spend a lot of money on contracting out. Is that correct?

Dr. SCHAFER. Yes, Mr. Chairman. Actually, the reason is the same as the one I gave to the prior question. We have difficulty in those scarce medical endeavors like radiology and anesthesiology and pathology. We have difficulty in recruitment and retention of first-class, quality, medical personnel, and under those circum-

stances many times we have no recourse but to contract for such services.

But from those experiences, though some are quite satisfactory, we have learned some of the vicissitudes that one can encounter.

Mr. MONTGOMERY. Mr. Jeffries?

Mr. JEFFRIES. No questions.

Mr. MONTGOMERY. Thank you for coming this morning, both of you.

Mr. Won Pat, I know you just walked in. We'll call on you in a few minutes after the next witness. But I do appreciate your being here this morning.

Mr. WON PAT. I apologize. I had to attend another meeting first.

Mr. MONTGOMERY. You always show up, though. Thank you, Mr. Won Pat.

Dr. Schafer, thank you very much for testifying this morning. It's been most helpful.

Dr. SCHAFER. Thank you.

Mr. MONTGOMERY. Our next witness is Mr. C. William Pollard, president and chief operating officer of the ServiceMaster Industries Inc., and looking in the audience I see an old friend of ours, a former Member of Congress from California, whom I certainly enjoyed serving with. He's very talented and we appreciated very much him showing an interest in this and being at this hearing this morning. Welcome to the committee.

Mr. Pollard?

STATEMENT OF MR. C. WILLIAM POLLARD, PRESIDENT AND CHIEF OPERATING OFFICER, SERVICEMASTER INDUSTRIES, INC., ACCOMPANIED BY ROGER ERWIN, SERVICEMASTER INDUSTRIES, INC.

Mr. POLLARD. Thank you, Mr. Chairman. I have with me this morning Roger Irwin, who is responsible for our relationship with governments and providing our services, and I have submitted a written statement that I would like admitted as part of the record. I will summarize that in a brief oral presentation which I will proceed with now, Mr. Chairman.

Mr. MONTGOMERY. Yes, you may proceed and your full statement will be put in the record.[1]

Mr. POLLARD. Thank you.

Mr. MONTGOMERY. You may introduce the other witness with you.

Mr. POLLARD. All right. This is Mr. Roger Erwin from ServiceMaster.

Mr. MONTGOMERY. OK.

Mr. POLLARD. We thank you for the opportunity of appearing before you today and testifying with respect to A-76, specifically section 601 of Public Law 97-66. We believe that today, however, Mr. Chairman and members of the committee, that the issue goes beyond section 601 and A-76. It raises a basic question of Federal policy. Namely, is the Federal Government, through its various agencies of health care and other related services, willing to practice what it has preached and even mandated to the private health

[1] See p. 50.

care sector, namely, to contain and reduce health care cost through increased utilization and improved productivity.

One way that the private sector is responding to this challenge is the use of supportive management services provided by firms such as ServiceMaster. We submit that not only the VA but every agency of the Federal Government should be encouraged—in fact, directed—to open up and consider these proven management services as a way of using the competitive forces of the free enterprise system to assist in bringing improved quality of service with increased productivity.

ServiceMaster is the leading provider of management services to the health care community for the nonmedical support departments of housekeeping, plant operation and maintenance, laundry and linen services, clinical equipment maintenance, materials management, and food service management. We currently provide our services in over 950 health care facilities, which include hospitals ranging in size from fewer than 50 beds to over 1,000 beds. We serve all major segments of the health care community, including large university and teaching facilities, multiple hospital systems, both proprietary and not for profit, hospitals owned and operated by local and State governments, and local community hospitals.

With the exception of the U.S. Air Force hospitals, the only significant segment of the health care community not open to these management services are hospitals operated by agencies of the Federal Government. Our service is a management service which is typically provided by our onsite manager managing the hospital's employees, performing the designated function in accordance with agreed-upon standards at a guaranteed overall cost. It is important to note here that as an alternative to having all of the employees on the contractor's payroll, our service can be delivered to the VA hospitals using, not replacing, their existing labor force, including those in the labor force who are veterans.

What are the results of these efforts? Here are just a few examples. We have initiated an energy management program which was recently cited at the national convention of the American Hospital Association. ServiceMaster was commended for this program that reduced energy consumption by an average of 18 percent in the hospitals we serve, a cost savings of $5.7 million, a reduction of 770 billion Btu's, enough energy to power 31 100-bed hospitals for 1 year.

In the past 4 years we have introduced seven major technical improvements in our housekeeping program and the net effect of these improvements is a substantial productivity increase for the hospitals we serve.

The chemicals and cleaning products and equipment we use in the delivery of our housekeeping management system are developed and manufactured by us. However, we are not in the business of simply selling products. Our business is based upon the delivery of an efficient management program. Unlike some product peddlers who have previously testfied on this issue before you, who work on high profit margins with a desire of simply increasingly overall product usage, ServiceMaster is interested in reducing product usage.

For example, in one recent equipment innovation we succeeded in reducing by two-thirds the amount of germicidal disinfectant required for cleaning hard-surface floors, while at the same time reducing the bacteria count and shortening the labor time.

Why shouldn't the Federal sector be open to the dynamics of these benefits? As I mentioned in my earlier remarks, the only Federal segment using hospital supportive management services is the U.S. Air Force system. We have had the privilege of serving in a number of these hospitals and in addition to improving overall cost, we have been able to significantly reduce employee turnover, add job-skill training and education, provide, for example, in one such facility, an opportunity for over 30 housekeeping employees to earn their high school degrees.

Congressman Dan Rostenkowski, chairman of the House Ways and Means Committee and former chairman of the Subcommittee on Health, noted in an address given a few years ago the significant contribution that ServiceMaster has made to the health care community, and he commended ServiceMaster for its efforts in delivering a more organized and efficient supporting management program for hospitals.

At that time he encouraged us to continue to participate in the process of increasing the efficiency of the health care delivery system. We believe that our appearance before you today is in furtherance of that word of encouragement.

As president of ServiceMaster and also as a member of the board of the National Committee on Quality Health Care, I am interested in seeing that the Federal sector has available to it the same programs and benefits found to be effective in the private sector. It is not necessary to conduct a $10 million or $20 million survey in order for the VA to consider these benefits. The Air Force already has proven what the private sector also has found, namely that the costs of survey and analysis typically are borne by those who desire to deliver the service. The competitive nature of the marketplace allows the customer to consider the best alternative, including a fair comparison of the alternative of in-house management. And this can be done without significant cost to the VA.

We suggest that the VA undertake a pilot program involving a responsible and responsive management firm such as ServiceMaster, serving a select group of VA hospitals to determine the benefits of supporting management services as an alternative to the present in-house program.

The results of this pilot program should be reported to this committee with further consideration regarding whether such a program should have VA system-wide application.

The time and cost for considering such a pilot program would be nominal.

Thank you, Mr. Chairman.

Mr. MONTGOMERY. Mr. Pollard, thank you for appearing before the subcommittee today and for providing us with your views on OMB Circular A-76. Before I defer to the other members for their questions, I would like to make a few comments.

You mentioned cost containment as a primary consideration in hospital management. We recently received a copy of VA's study of a comparison of 1980 figures for health care delivered in VA hospi-

tals versus private hospitals, which shows that VA medical care is 18.3 to 22.5 percent less expensive. This means it would have cost the taxpayers $458 to $556 million more to send veterans to private hospitals for treatment in 1980.

You also mentioned your energy conservation activities. I think it is important to note here that the VA told us at our last budget hearing that they saved $39.8 million in 1980 by their energy conservation measures. When you consider that the VA has 532 graduate engineers who administer training to the building maintenance staff and over 700 staff received formal training at the VA engineering training centers or manufacturer's training sites annually, it would be difficult for a contractor to duplicate this training effort.

This training effort, which includes 50 building maintenance or housekeeping trainees in university training each year, provides a support team which the VA physicians have told us is an integral part of the hospital staff which provides high-quality health care at a patient/staff ratio which is much lower than the private sector or DOD.

Actually, the concern I have is I with two Air Force hospitals or facilities where you furnish personnel and then in the other areas you furnish management and the Air Force furnishes the employees. Is that correct?

Mr. POLLARD. In all of the Air Force hospitals, Mr. Chairman, employees are on our payroll and we provide management plus the employees involved in production work. That's the way that the Air Force has chosen to contract for the services.

Mr. MONTGOMERY. What about in private hospitals?

Mr. POLLARD. In private hospitals the vast majority of the private hospitals we serve in, we provide the management and we manage the hospital's employees.

Mr. MONTGOMERY. You manage the hospital employees?

Mr. POLLARD. Right.

Mr. MONTGOMERY. Mr. Solomon?

Mr. SOLOMON. Mr. Pollard, are any of the employees in any of the locations in your organization, are they unionized, any of them?

Mr. POLLARD. Yes. We serve, of 950 hospitals, I don't have an exact count, but approximately 200 of those hospitals have union, employees are union.

Mr. SOLOMON. Your employees?

Mr. POLLARD. In some cases they're our employees. In most of the cases they're the hospital's employees.

Mr. SOLOMON. But where you provide the service with your employees and not the management——

Mr. POLLARD. Yes; as I indicated, those are a small percentage of our total hospitals, but in some of those situations they are unionized, yes.

Mr. SOLOMON. Have you ever had a strike?

Mr. POLLARD. In over 20 years of serving health care we have had some strikes. We have had no major disruptions.

Mr. SOLOMON. Some strikes but no major disruptions?

Mr. POLLARD. Right.

88-212 O—82——2

Mr. SOLOMON. It's my understanding that your company does management consulting work and management advisory work but that you also sometimes contract for a particular function of a hospital and completely run it. Can you tell me the various methods of operation? Give me some examples of that?

Mr. POLLARD. We don't offer a consulting service. We only offer a management service. When we contract with a hospital we are responsible for the performance of the entire function, whether it be housekeeping or plant operation and maintenance, laundry. Typically, the contract will define the service to be delivered, the cost for the service, and it will carry ServiceMaster's guarantee for the total cost.

It would typically involve our onsite manager supported by other management in our organization and, as I indicated, in a typical case, managing the hospital's employees, we perform this function in accordance with agreed-upon standards of performance.

Mr. SOLOMON. OK. In your testimony you indicate that your company's cost for supplies in service contracts is 5 percent. What's the other 95 percent made up of?

Mr. POLLARD. Well, a major portion of it is labor, Congressman. That represents the balance of that function, both production labor and management labor.

Mr. SOLOMON. In other words, you must build in a certain profit margin, I would think.

Mr. POLLARD. Yes.

Mr. SOLOMON. Is that a set figure in your bids in any way?

Mr. POLLARD. Well, it's a figure that's consistent with what our published statements are for a public company. We are a public company. Our profit margin, after provision for income taxes, is 3 percent—3 percent.

Mr. SOLOMON. Three percent, right.

I think my last question, have you ever made any comparisons between private hospitals and governmental hospitals in terms of relative costs? In other words, where you provide the service to a private hospital and to a governmental hospital is there any difference in those costs?

Mr. POLLARD. No; there isn't enough of a correlation there as to the owner and the distinction of the function to show any meaningful statistics. As I indicated, we do serve in a number of facilities owned by States or owned by local county governments.

Mr. SOLOMON. I have no further questions.

Mr. MONTGOMERY. Mr. Jeffries?

Mr. JEFFRIES. I have a couple or three questions, Mr. Chairman, thank you.

Mr. Pollard, you can help me a lot by telling me how many firms are there such as yours that provide this type of service?

Mr. POLLARD. I don't have an exact count, Mr. Jeffries, but there are a number of local and regional firms and there may be two or three national firms in addition to ServiceMaster, providing at least the housekeeping/management program. Some of them provide some of the other services which we mentioned as well.

Mr. JEFFRIES. The reason I asked that, frankly, I just didn't know how many firms there might be or what the size of them is, but you are a public firm?

Mr. POLLARD. Yes.

Mr. JEFFRIES. Are there other public firms that you know of?

Mr. POLLARD. Yes. There are, when we talk about food service management, for example, Marriott, ARA Services are two examples of large public firms.

Mr. JEFFRIES. They're in this same field?

Mr. POLLARD. Right.

Mr. JEFFRIES. They are?

Mr. POLLARD. Food service management.

Mr. JEFFRIES. OK. I thank you for that.

Now if you'd help me with this. What is your renewal experience in respect to contracts in the private sector?

Mr. POLLARD. With respect to the period of our service, as I indicated, we have been serving since 1962 health care communities. We are serving in the hospital that we first served in 1962, and our renewal rate, on average, over this period of time, has been 95 percent.

Mr. JEFFRIES. Since 1962?

Mr. POLLARD. That's right.

Mr. JEFFRIES. OK. Another question. Have any of your companies ever been terminated for any reason during the lifetime of a contract?

Mr. POLLARD. Yes. As I understand the question, have any of our contracts been terminated?

Mr. JEFFRIES. Terminated.

Mr. POLLARD. Yes.

Mr. JEFFRIES. What are the basic reasons?

Mr. POLLARD. Well, there are several reasons. One is change of administration and a desire to change the management team, including contract service. In recent years there are some hospitals who have been unable to pay for our services and, in fact, we have experienced some hospitals going bankrupt, which is a recent phenomena. We're not perfect. In some situations we've had a performance problem, and we've been terminated for that reason.

Mr. JEFFRIES. I'm not casting any aspersions.

Mr. POLLARD. No, but that kind of gives you a spectrum of the reasons and really in the delivery of our service we are not providing the service necessary for the hospital unless our manager becomes one of the best department heads that that adminstrator has in the hospital, and unless we fully integrate with his other management team, we typically will not build the relationships necessary to get the job done.

Mr. JEFFRIES. Do you feel that there's any condition prevalent today where your services become more important than, we'll say, some years in the past or conditions?

Mr. POLLARD. Yes; in both the public sector and the private sector there is an increased complexity in the management of the health care institutions and you can imagine, Mr. Congressman, that if the institution is not clean it involves everyone, and if an adminstrator must assume 30 to 50 percent of his time dealing with problems in a housekeeping function, which typically is a low percentage of his total cost, but which affects many people.

In the private sector, for example, the housekeeping function as a percentage of the total budget is around three percent or less, but

at the same time it can represent 50 percent of his problems if it's not done right, and as he is continually faced with increasing complexities in management, the importance of having professional management at this level is key to him.

Mr. JEFFRIES. On the complexity, becoming more complex, what's the basic reason for this business becoming more complex today than it might have been in the past?

Mr. POLLARD. Some of the additional laws and regulations passed by Congress as it relates to the operation of health care institutions and certainly the need to contain health care costs is an accelerating factor, and those are some of the factors that have added to the complexity as well as just the increased technology for the delivery of health care.

Mr. JEFFRIES. But would you say that the main cause for complexity and so forth in this business has been caused by the government?

Mr. POLLARD. It's been a significant factor, Mr. Congressman.

Mr. JEFFRIES. No further questions.

Thank you, sir.

Mr. MONTGOMERY. Mr. Won Pat?

Mr. WON PAT. Thank you, Mr. Chairman. Mr. Pollard, your organization is engaged, as you pointed out, plant operations and maintenance, food service. You do not get into the administration of a hospital?

Mr. POLLARD. No; we do not, Mr. Congressman. We have limited our activities to the supporting services and we support administration in providing our services.

Mr. WON PAT. That's the reason why I ask. I am personally aware of the situation in my district. We have four different groups trying to do this. That is why I ask about that, because your organization has done a rather commendable job in this, in the management.

Judging from your statement, your organization ought to be commended where you have contracts.

Mr. POLLARD. Thank you.

Mr. WON PAT. I don't have any further questions.

Mr. LEATH. Mr. Pollard, I apologize for getting here late. I didn't hear all your testimony. I had an earlier meeting.

I'd like to follow up a little bit on the questions that Mr. Solomon asked you. I have a couple of very large VA hospitals in my district and supposing you had the contracts for the entire spectrum of what you provide, housekeeping, plant operations, laundry, clinical maintenance, materials management, food service, and so forth, and the collective number of those employees did become unionized and went on strike, what would you do?

Mr. POLLARD. Well, you're phrasing a hypothetical that would——

Mr. LEATH. Well, I'm raising a question.

Mr. POLLARD. Depending upon the specific facts and circumstances, but it's not one that is—that we haven't had to face before, Mr. Chairman.

Mr. LEATH. I understand that. If I have 300 or 400 veterans in a hospital and they have no support services because of a strike, what happens?

Mr. POLLARD. We provide supporting management to fill those roles, those production roles, and I would say, Mr. Chairman, that there isn't another company in this country that has the people resources that ServiceMaster has as part of serving 950 health care institutions.

Mr. LEATH. Will you put in your contract that if those employees went on strike that you would still provide those services so that our nurses didn't have to do it and so that we could continue to take care of those veterans?

Mr. POLLARD. That is a typical provision of our contract. As I indicated, we have a performance contract and we must perform the service. That is the obligation we assume in every hospital that we enter into a contract with, that that service will be performed by ServiceMaster. Our guarantee, our resources, are behind that commitment.

Mr. LEATH. Do you have an excess of people on your staff that you could bring in immediately to fill those jobs?

Mr. POLLARD. Yes.

Mr. LEATH. Well, that's a great concern to me because I think that that's a potential problem that we have to be concerned about.

Mr. POLLARD. I can understand the concern. I would only, again, say that as part of our experience now over 20 years in serving the private sector, this has not resulted in a major disruption to any of our customers.

Mr. LEATH. Do your current Air Force contracts contain these provisions, performance provisions?

Mr. POLLARD. The current Air Force contracts contain those performance provisions and in those situations, as I indicated, the employees are on our payroll.

Mr. LEATH. Would you provide for the record for us, please, the Air Force hospitals which now contract out for your services, the type of service that you have in those contracts, and the monetary amount of each contract? Secondly, what percentage of the Air Force employees displaced by the contracts have been retained by your company after receiving the contract? [1]

Finally, the number of government contracts that you have had for 3 years or more reflecting each year's cost, including, of course, the initial bid, and the reasons for any adjustments in the cost up or down? You can just submit that to the record for us. I wouldn't expect you to have to do it at this point. We'll give you a written list of those things if you didn't catch all of it.

Mr. POLLARD. Right. We'd be glad to do that.

Mr. LEATH. Does anyone else have any questions? Does counsel have any questions?

Mr. FLEMING. No, Mr. Chairman.

Mr. LEATH. Well, Mr. Pollard, thank you very much.

Mr. POLLARD. Thank you, Mr. Chairman.

Mr. LEATH. Our next witnesses will be a panel consisting of Mr. Raymond Kalpin, president of Harry A. Stroh Associates, James Netterstrom, president-elect of Building Service Contractors Association International, Mr. Alfred Bromberg, director of marketing of Crothall Hospital Services in Freehold, N.J. Gentlemen?

---

[1] Not received at time of publication.

STATEMENT OF A PANEL CONSISTING OF RAYMOND KALPIN, PRESIDENT, HARRY A. STROH ASSOCIATES, JAMES NETTERSTROM, PRESIDENT-ELECT, BUILDING SERVICE CONTRACTORS ASSOCIATION INTERNATIONAL, AND ALFRED BROMBERG, DIRECTOR OF MARKETING, CROTHALL HOSPITAL SERVICES

Mr. LEATH. Mr. Kalpin, if you'd like to lead off for the group and then we'll take it from there.

STATEMENT OF MR. KALPIN

Mr. KALPIN. Mr. Chairman, members of the subcommittee, I would like to ask that my complete remarks be included in the record.

Mr. LEATH. Without objection.[1]

Mr. KALPIN. On behalf of Harry Stroh Associates, I'd like to make brief testimony on Circular A-76 and whether or not the private sector can provide complete services as required.

Harry Stroh Associates has been specializing in hospital housekeeping services since 1951. In more recent years it's expanded into physical plant management and other related services.

It is without doubt that established firms in the private sector can provide complete services as required. In addition, the private sector can provide services more effectively and efficiently in most cases at considerable reduction in cost. Firms in the private sector are continuously involved in research, develop materials, equipment, methods, systems and procedures which will increase productivity levels.

Our corporate goal has to been to offset inflation by greater productivity methods. The capability of the private sector providing required services has been successfully demonstrated in a program referred as "Hospital Aseptic Management Services," known as HAMS. HAMS was developed by the Surgeon General's Office in conjunction with the Air Force. In 1976, contracts for nine hospitals were awarded to the private sector. The number of hospitals have increased each year to a current number exceeding 30 hospitals. The program has been so successful that the Surgeon General's Office is currently requesting proposals for a similar program in "Medical Facility Real Property Maintenance Management" for a select group of hospitals.

The HAMS program can further support the private sector by contract renewals. Analysis of the contract renewals will general show that, while the requirements for the services increased, the contractors in the private sector were able to reduce their labor man-hours, thereby, keeping a lid on rising costs.

I have attached to my submittal a letter from our Senator, Bill Bradley, concerning a hospital in Utah at Hill Air Force Base, where the Government awarded a contract and over a 3-year period is saving $235,000 while improving services.

We thank you for this opportunity to present this testimony and assure you of our continued support for the project.

Mr. LEATH. I think we'll hold any questions until the whole panel is through. Mr. Netterstrom, would you like to proceed?

---

[1] See p. 58.

STATEMENT OF JAMES NETTERSTROM

Mr. NETTERSTROM. Mr. Chairman and members of the committee, my name is James S. Netterstrom, CBSE. I am owner and president of Ship Shape Maintenance Co., Inc., a Washington, D.C., firm. I am also president-elect of the Building Service Contractors Association International, which is headquartered in Vienna, Va.

I am accompanied by Alfred Bromberg, who is the director of marketing for Crothall Hospital Services, one of our member companies.

This statement is being submitted on behalf of the Building Service Contractors Association International, which has 1,300 member companies. These companies are primarily engaged in providing cleaning services on a contract basis.

Our association strongly supports OMB Circular A-76 as being in the best interest of the Federal Government and the taxpayers. Cost comparisons between in-house cleaning and contract cleaning are very likely to indicate the Veterans' Administration could realize savings similar to those found in the Comptroller General's Report to the Congress relative to cleaning costs of the General Services Administration.

It may be helpful to compare costs in Great Britain, where hospital cleaning is all performed by government employees, with the costs in the United States. In Great Britain, hospitals spend 8 to 8½ percent of their total operating budgets for environmental services. In the United States, hospitals spend 3 to 3½ percent of their total operating budgets for similar services.

Another comparison that may be helpful is the cost per square foot for cleaning Veterans' Administration hospitals and the cost per square foot for cleaning other hospitals in the United States.

According to the data obtained from the Veterans' Administration for fiscal year 1980, the average cost for cleaning all Department of Medicine and Surgery Hospitals is about $2.75 per square foot per year. The Hospital Administrative Services Division of the American Hospital Association reported data for the 6 months ending December 31, 1980, which indicates the annual costs for cleaning hospitals is $1.90 per square foot in hospitals with 200 to 399 beds, and $1.08 per square foot in hospitals with 400 or more beds.

Using the higher cost figure of $1.90 per square foot for comparison purposes, the Veterans' Administration could save $46,230,000 per year by contracting for full-service cleaning.

There is no factual basis to indicate that cleaning services provided by contractors would lower the quality of the services as now provided by the Veterans' Administration employees. Hundreds of hospitals are currently being cleaned by contractors in all sections of the country and many of these contracts have been in force with the same contractor for several years. For example, Crothall Hospital Services cleans more than 100 hospitals. Eleven of these have 500 or more beds and they are listed in my full statement. In that listing, you may observe that one hospital has been under contract for 15 years and two others for 10 years.

Some groups have expressed a fear that services provided by contractors may be disrupted by strikes. This should not be a fear for housekeeping or cleaning services. More than 80 percent of the

building service contractors employ nonunion employees. Furthermore, strikes in the building service contracting industry are almost unheard of.

Contractors, particularly those providing cleaning services to hospitals, have the capability of providing service at any location. It is a common practice among building service contractors to have branch operations in multiple locations.

Those contractors who clean hospitals have proved they have the capability to perform the highest level of cleaning. They have the necessary employee training and quality control to perform in accordance with the job specifications.

Our association is dedicated to developing a high level of professionalism among its members. To this end it has established extensive educational programs for executives, managers, and employees of building service contractors.

Our association respectfully requests that the Veterans' Administration Department of Medicine and Surgery be required to implement the cost studies called for under OMB Circular A-76.

Mr. Chairman, this completes my statement and Mr. Bromberg and I will be pleased to respond to any questions that you and members of the committee might have.

Thank you for your attention.

Mr. LEATH. Thank you, sir. Mr. Bromberg, I understand you don't have a statement?

Mr. BROMBERG. That's correct.

Mr. LEATH. You're just going to respond to questions?

Mr. BROMBERG. Yes.

Mr. LEATH. Mr. Jeffries?

Mr. JEFFRIES. Thank you, Mr. Chairman. I have a couple of questions.

Could you give this committee an indication of your salary structure as compared to the Federal salary structure? The salaries that you're paying. The salaries that you're paying the people to clean and so forth.

Mr. NETTERSTROM. It ranges, quite truthfully, in the private sector. It can range from minimum range up to whatever—if it happens to be a union job—the union wage scale may be used.

If you're dealing with the Government, which would be the case with the Veterans' Administration, all of those jobs would fall under the wage determination, because of the Fair Labor Standards Act. And for instance, currently in Washington, D.C., the wage determination is $4.31 an hour plus 32 cents an hour health and welfare benefits, against $3.70 an hour, which is the minimum wage in the District of Columbia for our services.

Mr. JEFFRIES. Well, then should a group such as that take over in the VA, and they're going to be some displaced Government employees, and you have said that you would probably take them on——

Mr. NETTERSTROM. Yes, sir.

Mr. JEFFRIES [continuing]. At what prevailing wage would they be taken on? At the rate they were displaced or some new rate?

Mr. NETTERSTROM. It would probably be at the rate the wage determination was issued at, which, of course, the contractor has no control over. That is given by the Department of Labor. They

issue the wage determination, and that, in turn, would establish at least the minimum wage that could be paid on that contract.

In many cases, truthfully, the wage determination that is issued by the Department of Labor represents a union contract that may be inforce at that time, which is rather interesting because, if the Government employees were unionized, then the wage determination that would be issued by the Department of Labor would reflect the wage rate being paid by the union, and therefore, there wouldn't be any loss of benefits whatsoever.

Mr. BROMBERG. Mr. Jeffries?

Mr. JEFFRIES. Oh, yes. I didn't know where that was coming from.

Go ahead.

Mr. BROMBERG. There are two aspects with respect to displacement of people that we've known in the private sector. One, we may be using fewer productive staff, but we do offer an opportunity for upward mobility to staff that are retained.

For example, when we started in our business at Crothall here in the States 11 years ago, we had one hospital. Today we do, I believe, it's 107 hospitals in the States.

The growth of people from the original hospital—many of them became supervisors in our organization, later on, managers, and had a path of mobility that they normally do not enjoy being employed by a single hospital. It's a pattern of growth that I know we've used. It's the pattern our competitors at ServiceMaster use and that Mr. Kaplin has used. And people consideration—I think the potential for upward mobility and individual growth is very frequently overlooked.

Mr. JEFFRIES. All right. Thank you, Mr. Bromberg.

No more questions, Mr. Chairman.

Mr. LEATH. Mr. Won Pat?

Mr. WON PAT. Thank you, Mr. Chairman. With respect to contracting in certain areas, in small centers of population, they would tend to employ the local people? In such a case, do you think it would be cheaper to contract the work or cheaper to employ the local people?

Mr. BROMBERG. Mr. Won Pat, if I may, your question applies not only in a smaller community; it can even be in a large city like New York where you're dealing with a neighborhood population. That is just as critical.

The gains that we generally get are based on some improved productivity and good management practices. We don't ordinarily think in terms of bringing people from outside into a community. This would be almost prohibitive in terms of the cost of moving and replacing people on that basis. So you do, almost always, continue to have a good sense of community, whether it be a large community, a neighborhood or a very small, isolated community.

Mr. WON PAT. That came to my mind because in my district we are used to bringing in outside people and it causes tremendous difficulty with the local people.

Mr. NETTERSTROM. Sir, I know of no instance where the labor of any contract was brought in from an outside area. You employ local labor. You may bring in a manager, but all of the labor and

most of the supervisory personnel come from the area in which that facility happens to be located. In our business, at least.

Mr. WON PAT. You would still probably bring in the skilled people, wouldn't you?

Mr. BROMBERG. We'll bring in skilled people to train many of the local people. The object there is that we do have training staffs, people who do move within our company to provide training of those local people to bring their skills up to acceptable levels and we again get improved productivity.

Mr. WON PAT. In Guam we have the Naval Hospital and they won't contract because they have their own employees, even though it would be cheaper to contract.

No further questions, Mr. Chairman.

Mr. LEATH. Thank you, Mr. Won Pat.

Gentlemen, I understand that if you look at any industry or if you looked at any operation of a like kind in a large enough area that you would find some efficient areas and some inefficient. But, could you give me some ideas as to generally speaking why a private contractor can come in and do a job cheaper if you have an efficient staff that's already doing that job? One thing that comes to mind is that the VA has the outstanding record in the nation, both public and private, of energy savings in their engineering department, and if you have an operation that's being performed efficiently with dedicated employees, what is it that you do different that is going to make it so much cheaper?

Mr. BROMBERG. Mr. Leath, where you have an operation that's being run by dedicated people at high efficiencies, in all probability we would not be able to do it cheaper or do it better. It would be incorrect for me to say that we have an ability to produce better than the most efficient. That would not be correct.

We find, however, that there are many, many operations that are well below the optimal in terms of efficiencies in our business, which is basically the hospital housekeeping and laundry service business.

The majority of hospitals that we've seen in the public sector do offer opportunities for both the delivery of a more responsive and more efficient service and at some savings. In those cases that you cited, though, when those things were already optimal, we can't do any improvement there.

Mr. LEATH. But you're not telling me anything definite that you can do that, as a general rule, will increase efficiency? Are you paying lower salaries? Do you have to kind of skimp a little bit on some of the things? For example, in an operation as complicated, with as many different things that happen as a hospital, for example. There might be many, many instances where an employee, if he's under the control, total control, of the director of that hospital or the management of that hospital, in this case being the VA personnel, that though his primary job may be to mop the floors, in certain emergency situations he might have to do certain other things. How would we handle that if your man is contracted to mop the floors and he says, "No; I don't believe that I'm getting paid to do that"?

Mr. NETTERSTROM. Sir, in the General Services Administration contract for janitorial services, they provide for a provision for

emergency work, such as snow or fire, or flood work, and what you would simply do is you divert the work force from their normal cleaning duties and go ahead and handle the emergency.

Mr. LEATH. Does that mean that we'd have to say you're required, if a patient needs this, that, or the other, that you're required to do this, this, this, and this? You never know what's going to happen.

Mr. NETTERSTROM. No, sir.

What you're basically buying is labor. That's what really you're buying. You're buying time. You can write a contract whereby you're putting in time to do primarily housekeeping services, but those housekeeping services may be expanded into perhaps bedmaking. They could be expanded in every other fashion. What you simply do is, quite truthfully, the Veterans' Administration has even suggested they do within their own organization, and that's rob Peter to pay Paul. If they use housekeeping personnel to do nursing functions, that's what they like to do, and that's one of their arguments, "Hey, if you take away the housekeeping, you're taking away a certain amount of our flexibility."

Mr. LEATH. Of course, that's exactly what I'm trying to get at. We need that flexibility.

Mr. NETTERSTROM. You can have that flexibility through contract services.

Mr. BROMBERG. We've been serving hospitals in the States for 11 years but have been in the business for 43 years. We started in New Zealand. In fact, the first hospital we ever contracted with, in 1943, we're still serving. That's a fairly good record for continuity of service. The thing that makes that possible is the fact that it is a competitive business, you do have to provide responsiveness of service. You do have to be flexible to meet the needs of the particular facility. Our job is serving that administration.

We succeed most often when there is no schism, there is no contract or inside feeling. We look for our manager to be totally integrated within the organization and serve completely as one of the team. But he is following basic precepts and systems and training that we provide that does allow for productivity improvement.

Mr. LEATH. Do your contracts, as a general rule, with Federal agencies, require that you grant veterans preference in your hiring?

Mr. KALPIN. Generally speaking it's not preference but it comes under our affirmative action program where there is not discrimination because of veteran status. Everyone is given the same consideration. There are no points allowed because the person is a veteran.

Mr. LEATH. So what you're saying is you don't discriminate against him because he's a veteran but you don't give him any help either?

Mr. KALPIN. That's right.

Mr. LEATH. That's sort of a reverse from what we normally have in mind on this committee.

I have no further questions, either. Mr. Fleming?

Mr. FLEMING. Mr. Kalpin, as a follow up to the question just voiced by the chairman, may I explore the matter a little further.

We've never been able to get a definitive answer to the question just raised by the chairman, that is, how can your employees do the same job cheaper than Government employees? For example, Mr. Kalpin, in your statement you say that an analysis of the contract renewals would generally show that while the requirements for services increased, the contractors in the private sector were able to reduce their labor man-hours, thereby keeping a lid on rising costs. The question is how do you do that?

It seems to me you must do it one of two ways. Either you have fewer people doing the same job or you have the same number of people doing the job at less pay.

Mr. KALPIN. Let me answer that question by first going back to our own background that has been, since 1951, basically as management hospital consultants in the nonprofessional departments, and hospital housekeeping, one of the prime areas in which we address the problem. We've gotten into the management in the early seventies, but the difference, there are many differences. As a consultant we constantly went into hospitals that might be expanding services or might be adding another 5,000 feet or another wing. The hospital executive housekeeper or manager would take a look and say, "I need another person." Well, in reality, that area may have only required 5½ hours work and rescheduling of the entire department would make it operate more efficiently.

Where we feel that—we place the emphasis on the scheduling of the work. We place emphasis on those items that have to be done every day, 7 days a week, those items that have to be done five a week in 5-day areas, and we separate those areas that have to be done on a cycle basis, which is once a month or less. We never disrupt the daily routine service. If we're short a person then we forego the project work which we can catch up on on a weekend or in the evening. But the daily services remain.

We put the management concept into the program of developing the program and putting the total work effort into a meaningful program so that we can increase the efficiency and the productivity of the employees.

We, of course, place a lot of emphasis on management, management development, and we place a lot of emphasis on the training of the employees, and a combination of these factors, along with the factor of survival, we are a private firm that has to make a profit, we have to look for ways to increase efficiency and productivity. We have more of an incentive, perhaps, than a management team that is part of the VA hospital, although, to answer the chairman's statement earlier, Mr. Fleming, we do, even where we have full staff contracts, the hospital administration doesn't look upon us as an outside contractor. We're part of the hospital family. Our employees are part of the hospital family and are identified as such. The fact that there is invoice and billing for services doesn't reflect internally.

Mr. FLEMING. Are you saying that your management effort will save money by making for a more efficient and productive operation? Is that what you're saying?

Mr. KALPIN. I think that what we're saying is that in most cases we can improve the efficiency and productivity, based on our long experience. We don't have a lot of experience in the VA hospitals

outside of some site visits. But our experience has always been that we can increase productivity and efficiency of the department—in many cases improving services and in other cases improving services and reducing costs.

Mr. NETTERSTROM. How do you lower costs without reducing salaries or a decrease in man-hours?

You can't. There's no question about it. And quite truthfully, we as contractors don't really know whether, the Veterans' Administration, we can save them any money. Nor can the Veterans' Administration know that unless they're willing to make the cost comparisons necessary.

And quite truthfully, you'll have many cases as far as decreasing man-hours. New equipment may save a tremendous amount in man-hours, but they may not know that the new equipment is there and available. That can reduce cost.

If you go along and say, "Hey, last year we used 10,000 hours in cleaning this hospital, so therefore, this year we're using 10,000 hours to clean this hospital," you haven't tried to reduce any man-hours, all you know is you're staying in the same place and you're probably spending more money for it.

Another factor, I think, with respect to the outsiders, that is, contract cleaners, there may be a union involved, maybe they're going to bargain a little harder before giving a wage increase than does the Veterans' Administration who says, "OK, we'll pass it on to Congress."

Quite truthfully, in contracts that I've dealt with in Washington, D.C., in the private sector on hospital cleaning, and particularly where that contract is governed by a wage determination, where the union comes up and says, "'Hey, what difference does it make? We want a 20-percent increase in wage rates, and it doesn't cost you anything because the Government is going to pay for it." Well, I think that's totally ridiculous and they're coming at you as if you had no bargaining position at all.

This is where I think you're talking about cost savings. You're talking about future cost savings as well as present cost savings.

Mr. FLEMING. Well, there's no question if you don't have to worry about union agreements, and certainly, you can probably do a job at a lower price. I believe you said that 80 percent of your work force is nonunion. If that is the case, you don't have to be concerned with collective bargaining.

Now, the Veterans' Administration is concerned with its employees and the agency does negotiate labor union agreements with the American Federation of Government Employees and others. So, therefore, the negotiated agreements are a part of the process. Now, that may be one reason it costs more to provide this service in-house rather than through private contracts.

Mr. NETTERSTROM. Well, truthfully, sir, I don't think that you're going to get where you have a Federal employee covered by a union agreement who gets his salary reduced because the wage determination will reflect that union agreement.

Now in the future, down the road, with harder bargaining, and so forth on the part of the contractor, maybe then, you will see a savings in wage rates. But to start with, the wage determination

that will be issued by the Department of Labor will equal the union contract presently being paid to those employees.

Mr. BROMBERG. If you will, I would like to address you a question. You have tried the two alternatives for getting improved productivity. The trade off is equipment, as Jim has indicated, and it's all labor, and sometimes at a good saving.

We deal in the New York area, for example, with 1199, which is a very, very strong union in the hospitals. In one particular instance I can think of in producing pieces of equipment at the hospital, because of State restraints, could not invest in this capital equipment. We made an investment of about $30,000 in some equipment that resulted in improvements in productivity and a reduction of about six positions and positions costing the hospital about $18,000 a year. The trade off was excellent.

You were talking about roughly saving $95,000 or $96,000 in labor for $30,000 of equipment.

The hospital could not have made that investment because either getting certificate of usage approved or just going through the redtape to enable them to make the capital commitment.

So, there are alternatives in improving productivity to just reducing a wage.

Mr. FLEMING. I think Chairmam Leath just made the critical observation here, and that is, maintaining—and I think there is some validity to suggest that VA managers must have maximum flexibility to operate its facilities. Let me cite one example. In the Columbia, S.C. VA hospital last year, outpatient visits increased by some 18,000 over the previous year even though the funding level was the same. Obviously, as you suggested, or the other gentleman suggested, the hospital director probably borrowed from another medical account in order to pay for the increased visits, and that's true. I don't know how that could be done if you are required to contract out.

I don't know of any contract that you could enter into that would say, "We want you to provide '*X*' number of outpatient visits next year," and next year we want you to have 4,000 more visits at the same price. It's not reasonable I know, but that's what we mean by taking away the flexibility.

Mr. BROMBERG. Well, I can answer that only in the sense of looking at our own professional experiences. In Newark, N.J., one of the hosptials we serve there is a 525-bed facility. We've been there for 6 years now. Six years ago, they had one given level of outpatient visits and an occupancy rate. Today, they've had trouble, which is not uncommon in an inner-city environment—they've had trouble with their outpatient services.

In that 6-year period, out contract amount has actually reduced by about 6½ percent. So, we've become more productive, more efficient to meet some of the pressures they had, while they've added to outpatient service and actually increased their bed count by about 30 beds.

Mr. FLEMING. In that situation, are you talking about management service or full service?

Mr. BROMBERG. Management service.

Mr. FLEMING. Management service?

Mr. BROMBERG. Yes, sir.

Mr. KALPIN. Mr. Fleming, I would like to get back to your comment on unions and the fact that you can provide services at a lower cost without unions. We, in fact, do have a contract with Government service employees at a Federal institution. We've negotiated rates for that contract which are below what the Government would pay had it been a Government contract. Naturally, we are therefore in a position to provide this service at a considerable reduction in cost.

Mr. FLEMING. You're assuming that you're a better negotiator than the VA. I mean, when you say that——

Mr. KALPIN. I'm not saying that we're a better negotiator, but we are working under union contracts in a lot of cases and we're under pressure to negotiate, and we're additionally working with the Government Service Employees Union.

Mr. FLEMING. Well, my only point is, and the reason that I asked for the time from the chairman, is to suggest that it is sheer speculation on your part when you state that you can manage a system better than the VA. I am not arguing the point at all. You have had little experience with the VA. Most of your experience has been with DOD. The question always come down to who is the best manager, whether it's building maintenance, engineering service, food service, or what not? You couldn't have more dedicated employees than those who work for the VA. So, what you're suggesting to me is that you can manage the system better; that you can use the same personnel at the same price, and increase productivity through better management of the system.

Mr. BROMBERG. The best shot there is is to give it away. That's the easiest way I know of to prove it or to attempt to prove it or disprove whether we can do better in industry than they are currently doing in VA.

So, have us look at a number of VA hospitals, do a survey, offer proposals for what we feel that we would do. If it's below their current costs, isolate a few of those hospitals and perhaps measure over a period of 1 year or 2 years whether our contractor program is flexible, whether it meets the specific requirements of the VA, and whether we have fulfilled all of our obligations or promises with regard to the service to be tendered. I know we have demonstrated that very, very effectively in the private sector here in the States.

In New Zealand we do deal with government hospitals and we do about 50 of them there. In Britain, we do about 40 hospitals and they are largely governmental. In each case, we've done it because there were specific savings in terms of cost of management, and there was no compromise with respect to the service or, more importantly, in a hospital environment, the responsiveness of that service. One is as critical as the other.

Mr. NETTERSTROM. One of the points that—I, incidentally, think, heard the administrator testify for the VA health care facilities in Columbia, S.C. She's a very sharp lady.

Mr. FLEMING. Yes, Joan Kirshner.

Mr. NETTERSTROM. Yes, I heard her testify over on the Senate side, and she spoke particularly about this business of her need of flexibility. And of course, what she implied, of course, is you've got to give up something. I mean, if you've got somebody doing some-

hing else, he can't be doing what he was originally assigned to do. But that's understandable.

But there is one great question that I have, and that is, it's only because her needs, her demand, for those hospital services are increasing that she is placed in this position. Now, I would make the assumption that as the years go on and the services are continually in demand, that's fine, and also there's going to be a catchup. " 'Well, last year we spent this much so Congress will give us a little bit more this year and we can hire a few more people." What happens when the demand decreases? How do you get rid of them? A contractor, there's no problem with. But how do you, when you hire in-house people, then decrease services? Let's face it, the Government isn't exactly great on RIF'ing people, despite all the talk.

And that isn't too many years hence. I mean we're going to get less veterans, not more.

Mr. LEATH. Not in our lifetime.

Mr. FLEMING. That's right. The chairman said, and I think he's right, "Not in our lifetime." When you consider the aging World War II veteran population, some 12 million of them, are approaching the average age of 63, they will be needing medical care in increasing numbers. So the demand is not even upon us yet.

My purpose is not to argue with you. I simply wanted to discuss the issue with you. The statements I have read never seem to get into the specifics of how all of this work is going to be accomplished at less cost to the Government. It's always "We can do it better and we can do it cheaper." Well, maybe you can and maybe you can't. I was seeking to get some ideas from each of you on how you propose to do it, and that's the reason I keep coming back to it. Your answer always seems to be that "We will do it because we think that we can manage the VA work force better than the agency can do it." I would still like to see the specifics of how you can maintain quality with fewer people being paid less.

Mr. NETTERSTROM. Well, truthfully, Circular A-76 and the cost comparison called for would basically prove that. And you wouldn't even—if the Veterans' Administration is doing a better job in managing, and quite truthfully, I have no reason to believe that they are certainly not doing a good job in management in many instances, why, that will be proved in the cost-comparison study.

Mr. FLEMING. And it should be recognized—Mr. Solomon brought the question up before he left—that VA has got the authority to contract out. They've got the authority to do cost-comparison studies. The only thing that this committee did, through the law that was passed, was was to make certain that if the cost-comparison studies are made, that the costs paid with funds other than through appropriations provided for medical care or research. So VA is not precluded from making these cost comparisons.

VA has general authority to contract out in almost any area it cares to without further action on the part of this committee or the Congress.

Mr. LEATH. Thank you, gentlemen.

I would agree with Mr. Fleming that most of what we hear seems to be management expertise and I would just remind you again, as Chairman Montgomery pointed out in his statement, that studies show that we're able to deliver health care to the veterans

through the VA medical system at between 18 and 22½ percent less than we would be able to do that same thing through the private sector. So I just want the record to show that, in my opinion, particularly the three VA hospitals that are in my district that I am acquainted with, that we have as good a management techniques in the VA as we do in the private sector.

Nonetheless, we appreciate you gentlemen—all of you—for testifying here this morning.

This will conclude, in all likelihood, this committee's hearings on A-76 for this year.

I would ask that the record be kept open for 5 days to receive additional statements.

Do either of you gentlemen have any more questions?

Thank you very much.

We stand adjourned.

[Whereupon, at 10:16 a.m., November 17, 1981, the hearing was adjourned, subject to the call of the Chair.]

88-212 O—82——3

APPENDIX

Prepared Statement of Robert M. Gilroy, Senior Associate Director, Procurement, Logistics And Readiness Division, GAO

Mr. Chairman and Members of the Subcommittee:

We are here at your request to assist you in your oversight review of Office of Management and Budget (OMB) Circular A-76. It is our understanding that the Subcommittee is interested in any new information we may have on the current status of OMB Circular A-76 cost comparison studies within the Veterans Administration (VA) and its Department of Medicine and Surgery. Because GAO has not done any work at VA regarding Circular A-76, the Subcommittee has requested GAO to cite examples of reviews it has made at other agencies, and the results obtained, in two related areas of interest. These areas concern:

--The implementation of Circular A-76.

--The adequacy of agency actions to ensure good contractor performance of A-76-type activities.

The Department of Defense (DOD) has devoted considerable time and effort over the years to implementing the A-76 policy. Consequently, most of our reports concern that agency. These reports involve a wide assortment of functions, ranging from individual types of services to total installation support for a number of services.

IMPLEMENTATION OF CIRCULAR A-76--
EXAMPLES OF GAO REVIEWS AND RESULTS

Generally, our more recent reviews concerning the Circular's implementation have involved either (1) an evaluation of the propriety of a specific contracting-out decision at a given location or (2) a more comprehensive evaluation of an agency-wide or Government-wide nature. Our work in the first category is almost exclusively the result of constituency requests from individual members of the Congress and generally involve a detailed evaluation of an agency-prepared cost comparison.

Several examples of this type of work are as follows:

--We reviewed the contracting-out decision for laundry services at Wright-Patterson Air Force Base, Ohio. We agreed that contracting out was more economical than in-house performance and estimated a substantially higher savings than the Air Force primarily because it had

understated the number of in-house employees needed. (PSAD-80-17, December 7, 1979.)

--We reviewed the contracting out of 19 installation support functions at Fort Gordon, Georgia. The functions included, among others, maintenance, supply and service, transportation, and housing. We again agreed that contracting was more economical but estimated a reduced savings generally because the Army had overstated the number of cooks needed in the dining facilities. (PLRD-81-9, April 1, 1981.)

Our more comprehensive evaluations are typically reviews of broad issues surrounding the A-76 program or reviews of major functions of a commercial or industrial nature.

A few examples of this type of work are as follows:

--We reviewed 12 DOD conversions to contractor performance to find out how much contracting out was taking place because of personnel ceilings, wage differentials between Federal blue-collar and contractor employees, and other significant influences. This work was done in response to concerns expressed by the Senate and House Committees

on Armed Services. The functions we reviewed covered such activities as laundry and drycleaning, motor vehicle maintenance, aircraft maintenance, and total installation support of an ammunition plant.

We found that (a) the most significant reason for contracting out was that contractor costs were lower than in-house costs, (b) contractors' costs were lower because they planned to use fewer employees and pay lower wages, (c) although civilian personnel ceilings did not appear to be the primary reason for contracting out, the military services did use the A-76 program to reduce their work force, and (d) questionable cost comparison practices influenced some decisions to contract out. (PLRD-81-19, April 22, 1981.)

--At the request of the Subcommittee on Defense, House Committee on Appropriations, we reviewed a sample of 18 conversions by DOD of a variety of activities covered by Circular A-76. One of our primary objectives was to determine whether decisions to contract out might have been different if subsequent contractor price increases and performance shortfalls were known before the contract awards were made.

Most of the conversions did not result in performance shortfalls, but we did find unsatisfactory contractor performance was experienced on 5 of the 18 conversions. However, where contract price increases occurred, they seemed to be justified. In addition to the five unsatisfactory performance cases, we found that one conversion decision was based on an incomplete statement of work which was used as the basis for the cost comparison. While it is possible that if the information we found after the fact had been known before the contract awards were made, different decisions might have been made on these six cases, however, history doesn't provide alternatives. Unsatisfactory contractor performance was generally attributed to one or more of the following factors: high personnel turnover rate; unreasonably low staffing level resulting from a buy-in; untimely, improper, and/or poor quality work; too few skilled technicians; and inadequate training. (PLRD-81-58, August 26, 1981.)

--We performed a review which shows that the General Services Administration (GSA) is spending several million dollars more per year than is necessary to clean office buildings. Because of high wages and low productivity, GSA spent, in four regions studied, over 50

percent more to clean offices with its own custodians than with contractors, and almost twice what GSA landlords paid to clean Federal leased space. GSA is slowly converting to contract cleaning, but at the present rate this will take about 15 years. During this time, GSA may spend about $250 million more than necessary to provide cleaning services with its more costly, less productive custodians.

We recommended that GSA make the comparative cost studies required by Circular A-76 to determine whether cleaning services should be provided by its in-house staff or by contract personnel, and implement the results. We also recommended that GSA take specific actions to foster greater productivity and reduce costs of contract cleaning. (AFMD-81-78, August 24, 1981.)

ADEQUACY OF AGENCY ACTIONS TO ENSURE CONTRACTOR PERFORMANCE--EXAMPLES OF GAO REVIEWS AND RESULTS

Agencies should take several important actions both before and after a contract is awarded to better ensure good contractor performance of an A-76-type activity. Before award, an agency

should make sure that the statement of work used to solicit contractor bids or proposals (1) accurately describes what is to be done, and (2) includes performance standards for later determining how well the contractor has met the work requirements. Also, it should adequately evaluate the responsibility of the potential contractor. After award, an agency should effectively administer the contract to ensure that the contractor furnishes the item or service of an acceptable quality, on time, at the agreed price.

I would like to address now some recent reviews which have primarily focused on the adequacy of contract administration--what is done to ensure that the Government gets what it pays for and that work set out in contracts is actually performed. These reviews, therefore, were not started because of considerations involving Circular A-76, but to evaluate the adequacy of contract administration.

A few examples of this type of work are as follows:

--DOD accomplishes over half of its $1.9 billion annual real property maintenance, repair, and minor construction workload through contracts that are generally awarded and

administered locally. At 10 Army, Navy, and Air Force installations visited, we found that contract administration was not adequate to prevent intentional or unintentional overcharges.

Several installations paid for much more work than was done; some ordered unnecessary work and accepted inferior work; and lower prices were not obtained at some because requirements forecasts were unrealistic, work specifications were inappropriate or poorly written, and price proposals were not properly analyzed.

We recommended that DOD strengthen various controls over the procurement of these services. DOD generally concurred in our findings and recommendations. It conceded that the deficiencies were, in general, a result of a failure to follow existing policy and guidance. (PSAD-80-14, January 9, 1980.)

--In our review of food service contracts at 17 military installations, we found common contract units of measure and services were not used for contract bids and proposals and for making payments to contractors. This impeded evaluations of contractor bids and proposals and precluded

meaningful comparisons to determine the reasonableness of contract costs. The contract administration system for assuring satisfactory contractor performance lacked uniformity and was ineffective because contracts did not contain specific, measurable performance standards, tolerances allowed, and deduction rates for unacceptable performance; inspections and their frequency and documentation were inadequate; and inspectors were inadequately trained. As a result, some military installations paid for marginal or unacceptable performance, performed some of the contract work with military personnel, or terminated the contract and reawarded the contract--a costly process. Government meal estimates, which formed the basis of contractor bids and proposals, were inaccurate; and inadequate Government evaluations of contractor bids and proposals resulted in the award of some contracts to contractors that could not meet contract requirements. DOD concurred, in general, with our recommendations and indicated corrective actions have been initiated. (PLRD-82-3, October 20, 1981.)

--Our report on military contractor-operated parts stores (COPARS) and contractor-operated civil engineer supply stores (COCESS) showed that these contracts are unsound,

unmanageable, and exposed the Government to potential fraud and abuse. The stores provide the kinds of products found in neighborhood auto parts and hardware stores. The unsound buying practices and abuses we found were traceable to defects in the contracts and breakdowns in internal controls. Under the COPARS and COCESS contracts we reviewed, the Government's management control frequently broke down under the complexity of contract ordering and pricing, the sheer volume of transactions, and disorganized contract administration. We recommended that as each COPARS and COCESS contract expires, it should not be renewed. Instead, DOD should explore other means to buy these supplies. Government-operated stores purchasing from local commercial wholesale distributors at prevailing market prices is an alternative.

The fundamental concept of the COPARS and COCESS contracts makes administration of these contracts difficult because of the complexity and uncertainty of pricing the literally thousands of items covered by the contracts. We believe substantial contract administration costs would have to be incurred to provide adequately trained Government personnel who would assure the receipt of goods and that each item delivered is: (a) actually the item billed for, (b) properly

priced under the contract terms, and (c) the most favorably priced item that will meet the Government's needs. (MASAD-81-27, July 8, 1981.)

- - - -

In closing, we would like to say that although its implementing guidelines could be strengthened, GAO supports the general policy precepts set forth by Circular A-76. These precepts are: (1) Government reliance on the private sector is a valid principle, (2) certain functions are inherently governmental in nature and must be performed in-house, and (3) the taxpayer is entitled to economy in Government and cost comparisons are appropriate as criteria.

In 1978, we recommended, as did the Commission on Government Procurement in 1972, that the Congress establish a national policy relating to reliance by the Federal Government on the private sector to provide needed goods and services. (PSAD-78-118, September 25, 1978.) Without a firm national policy, the future of the A-76 program will be a repetition of the past--confusion, controversy, and ineffective implementation. The

policy must be stable and must appropriately balance many issues of national significance. It needs both legislative and executive branch endorsement and support.

Mr. Chairman and Members of the Subcommittee, this completes our formal statement. I will be happy to respond to any questions you may have at this time.

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

PROCUREMENT, LOGISTICS,
AND READINESS DIVISION

DEC 2 1981

The Honorable G. V. (Sonny) Montgomery
Chairman, Subcommittee on Oversight
and Investigations
House Committee on Veterans' Affairs

Dear Mr. Chairman:

This is in response to your letter of November 17, 1981, requesting, in connection with my appearance before your Subcommittee on that date, answers to four questions for inclusion in the hearing record.

Enclosed are my responses to the questions. If you or your staff require further assistance, please do not hesitate to contact me at 275-4268.

Sincerely yours,

Robert M. Gilroy

Robert M. Gilroy
Senior Associate Director

Enclosure

QUESTION NO. 1: You conclude that a firm national policy is needed relating to reliance by the Federal Government on the private sector to provide needed goods and services. What should this policy be based upon, OMB Circular A-76 or a congressional initiative which gives Government agencies more flexibility in negotiating contracts based upon local conditions?

ANSWER: The Congress should establish a national policy which sets the general bounds in which the executive branch must operate. On the one hand it must be firm enough to ensure some degree of uniform implementation among the agencies, but on the other hand flexible enough to ensure proper consideration of the many variables involved in reaching a decision on contracting out. These objectives cannot be balanced in the overall national interest without a clear idea of the policy's goal--in this case the extent to which contractors will provide goods and services needed by the executive branch.

We see the issue as one of congressional prerogative, and believe the precepts of the current executive branch policy represent an excellent starting point for congressional debate and the evolvement of a congressional policy. These precepts are (1) Government reliance on the private sector is a valid principle, (2) certain functions are inherently governmental in nature and must be performed in-house, and (3) the taxpayer is entitled to economy in Government and cost comparisons are appropriate as criteria. We would emphasize that the executive branch policy that all government functions must be performed by Federal employees should be highlighted in any congressional debate.

QUESTION NO. 2: The VA has testified that the cost comparison studies mandated by OMB Circular A-76 would have cost around $10 million, and would have to be absorbed from within the Department of Medicine and Surgery's direct health care budget. Granted, Public Law 97-66 has relieved the VA from this awesome fiscal responsibility. Notwithstanding this fact, do you believe that these cost comparison studies are cost effective, and would it not be appropriate to consider these overhead costs in the studies?

ANSWER: Concerning cost effectiveness of cost comparison studies, we have not, to date, attempted to evaluate the cost effectiveness of these studies when related to potential cost savings available from either contracting out or the use of a more efficient and effective in-house operation. We believe, however, that they should tend to be cost effective because the cost of making a study is for the most part a one-time cost that would be recovered thereafter through recurring annual savings.

In regard to whether these studies should be factored into cost comparisons, we have not yet taken a position but plan to in a forthcoming review of the A-76 cost comparison handbook.

QUESTION NO. 3: The VA recently testified that the Department of Medicine and Surgery spent $700 million for contract services out of fiscal year 1980 appropriations of $5.9 billion. This represents 11.7 percent of the total outlay. How does this degree of contracting compare with other executive agencies?

ANSWER: Statistical data on agency contract services, presumably of a commercial or industrial nature that could reasonably be performed in-house, similar to that presented by the Veterans Administration is not available at GAO. Also, such data is not available at OMB. Apparently it must be provided by each individual agency. To the extent possible, however, care must be taken to ensure that the data is comparable.

QUESTION NO. 4: Did your auditors find that Federal agencies, who have converted to contracts under Circular A-76, had adequate published staffing and productivity standards which could be used in developing A-76 statements of work? If not, do you think that these deficiencies could effect the substantial cost savings that have been indicated in, say, the Air Force hospital conversions?

ANSWER: We have not done extensive work in determining the validity of staffing and productivity standards. We have noted, however, several instances where agencies failed to use current data which would reflect the most efficient and effective means of carrying out a CITA function. Thus, they could have presented an in-house cost figure which was overstated. In answer to your question, deficiencies in standards could affect savings.

88-212 O—82——4

NATIONAL ASSOCIATION OF VA PHYSICIANS

P.O. Box 24042 Washington, D.C. 20024 (202) 387-8403

President
Rubin L. Siegel, M.D.
Wash., DC

Vice-President
Harold Ross, M.D.
Mountain Home, TN

Secretary
James A. O'Connor, M.D.
Bay Pines, FL

Treasurer
A. Raymond Pilkerton, M.D.
Wash., DC

Field Liaison Officer
H. P. (Peter) Hawley, M.D.
Wash., DC

Executive Director
Paul W. Schafer, M.D.
Wash., DC

I Heinz E. Schoenstefer, M.D.
West Roxbury, MA

II Thomas Kiernan, M.D.
East Orange, NJ

III Robert Saunders, M.D.
Washington, DC

IV Holcott T. Haden, M.D.
Richmond, VA

V Bernard Lieberman, M.D.
Miami, FL

VI Albert F. Muhleman, Jr., M.D.
Cincinnati, OH

VII Carl K. Liapcheff, M.D.
Allen Park, MI

VIII Gerald K. Morley, M.D.
Minneapolis, MN

IX Walter Brucki, M.D.
Leavenworth, KS

X Ralph M. Stanifer, M.D.
Houston, TX

XI James Benage, M.D.
Sheridan, WY

XII-S Robert M. Conroy, M.D.
Long Beach, CA

XII-N D. Robert Lewis, M.D.
Martinez, CA

STATEMENT OF

PAUL W. SCHAFER, M.D., EXECUTIVE DIRECTOR

NATIONAL ASSOCIATION OF VETERANS ADMINISTRATION PHYSICIANS (NAVAP)

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

OF THE

COMMITTEE ON VETERANS AFFAIRS

OF THE

UNITED STATES HOUSE OF REPRESENTATIVES

WITH RESPECT TO OMB CIRCULAR A-76

NOVEMBER 17, 1981

Mr. Chairman, Members of the Subcommittee:

My name is Paul W. Schafer and I appear before you as Executive Director of the National Association of Veterans Administration Physicians (NAVAP). I thank you for this opportunity to express our members' grave concern about OMB Circular A-76.

I am a physician, a surgeon and a scientist. I speak here today in a strictly unofficial capacity as Executive Director of NAVAP. I am a product of the Surgical Residency Program of the University of Chicago, where after a brief stint on that faculty, I left to become Professor and Chairman of the Department of Surgery at the University of Kansas School of Medicine in Kansas City. There I was actively involved in our affiliation with 5 hospitals of the VA System; namely, in Leavenworth, Wichita, Excelsior Springs, Topeka and Kansas City. I later served as Chief of Thoracic and Cardiovascular Surgery at the Walter Reed Army Medical Center and there trained a generation of Army Surgeons who served with distinction in Korea and Viet Nam. I now continue my service in the federal public sector as Chief of Thoracic Surgery and Chief of Electron Microscopy here in Washington, D.C. My current academic identification is as Professor of Surgery at Georgetown University.

The National Association of VA Physicians (NAVAP) is the largest single professional organization representing the more than 10,000 full and part-time salaried physicians employed by the Veterans Administration to care for the needs of sick and injured veterans. We serve in 172 hospitals and medical centers, in an even larger number of ambulatory care facilities and in other health activities. Though ours is a young organization, many of our members have long service in and much knowledge of the VA Health Care Delivery System.

We were appalled by the federal register of Wednesday, July 29, 1981. There on pages 38842 through 38866 we for the first time, without warning, saw the planned review schedules, part of the Agency's effort to implement A-76 in our 172 hospitals and medical centers.

On inquiry we were given naive assurances that none of the activities proposed for "contracting out" were directly concerned with the delivery of first quality health care to sick and injured veterans.

Permit me to examine what was proposed for a typical tertiary care VA Medical Center, like for example the Decatur (Atlanta) VA Medical Center. The following functions were to be served up for contractor consideration: Mail-out prescription services, Pharmaceutical Pre-packaging service, Plumbing/Steamfitting, Carpentry , Electrical and Masonry Maintenance, Painting, Air Conditioning/Refrigeration Maintenance, Grounds Maintenance, General Labor, Food Preparation and Delivery Service, Medical Transcription, Photocopy Services, Medical Records Processing, Storage, Retrieval and Maintenance, Clinic Appointment Scheduling, Storage and Distribution Services, Environmental Sanitation, Integrated Pest Management, Still Photography, Photographical Laboratory Services, Reproduction/Duplication of VA Products, Sound Recording Services, Graphic Arts Services, Closed Circuit

Television Services, Motion Picture Production Services, Script Writing Services, Medical Library Services, Keypunching Services, Chaplain Services.

I do not intend to tell you that none of these should be exempt from such considerations. Maybe we should contract some ground maintenance services, perhaps some aspects of security. It should certainly not be overlooked that the VA has regularly contracted out nearly half of its plant maintenance, repairs and operations. The irreligious might question even the need for chaplains and who knows about such things as the medical library and audiovisual activities.

The areas about which we are most concerned are those vital services which so closely support and are so intimately integrated into the major bed services of internal medicine, neurology, surgery, and psychiatry. Medical Records and Dietetics are such examples. A patient's management is sorely compromised if a complete and accurate record of prior medical events is not made promptly available to guide current treatment. Prescription dietary functions for seriously ill patients obviously require the closest possible therapeutic integration.

Though not directly treated in the proposed review, there are other existing contract experiences that should serve as warnings.

We know of RFP's resulting in multi-million dollar contracts where non-compliance is not only overlooked but is made the basis for major additional payments.

Full-time VA physicians have been pressured into private sector identification so that mercenary interests could contract for their proprietary service.

Scarce medical specialities like anesthesiology are really fair game with the result that contractors staff a tertiary VA Medical Center with nurse anesthestists instead of physicians anesthesiologists.

The first short term of a radiology service contract can look very attractive but what of the second and the third time around after all of the VA people are gone. The contractor then writes his own ticket.

We sincerely believe that the VA Health Care Delivery System is a national treasure that delivers a work product - namely good medical care for its sick and injured veterans - at a cost that cannot even be remotely matched by any segment of the private sector.

Beyond that, with the lessons of the Air Traffic Controllers in mind, it should not be overlooked that contractor employees will surely become targets for union organization - and they can strike.

And don't discount the disruptions that follow contractor bankruptcies and lesser business reverses.

In these times of economic travail what of the sheer number of dollars involved. Dr. Azar, Chief of Laboratory Service at the Minneapolis VA Medical Center has an annual budget of about $4,000,000. Were the

procedures that his service performs to be contracted out to the private sector in that community they would cost $40,000,000 per year, this is essentially the annual budget for the entire Minneapolis VA Medical Center.

In conclusion I would not wish to leave the impression that the VA cannot improve its delivery of health care to veterans and that it cannot become increasingly efficient in so doing, but what I do suggest to you is that even now veterans have a very good medical program costing the nation only a fraction of what that service would be billed by the private medical sector.

STATEMENT OF C. WILLIAM POLLARD,
PRESIDENT AND CHIEF OPERATING OFFICER OF
SERVICEMASTER INDUSTRIES INC., BEFORE THE
UNITED STATES HOUSE OF REPRESENTATIVES COMMITTEE ON
VETERANS' AFFAIRS, RELATING TO OMB CIRCULAR A-76.

November 17, 1981

Mr. Chairman and distinguished members of this Committee, I am C. William Pollard, President and Chief Operating Officer of ServiceMaster Industries Inc. Thank you for the opportunity to appear before you today and testify concerning the effects of Circular A-76 of the Office of Management and Budget on the Veterans Administration. Through the attachment of a rider to the recently signed Public Law 97-66, the Veterans Disability Compensation and Pension Amendment of 1981, the VA has effectively been restricted from implementing the intent of Circular A-76. This rider, Section 601, limits the VA in its consideration of proven alternatives in the management of supporting departments of a hospital, such as housekeeping, plant operations and maintenance, and food service.

The issue before you today goes far beyond Section 601. It raises a basic question of Federal policy. Namely, is the Federal Government, through its various agencies of health care and other related services, willing to practice what it has preached and mandated to the private health care sector, to contain and reduce health care costs through increased utilization and improved productivity?

One way that the private sector is responding to this

challenge is the use of supportive management services provided by firms such as ServiceMaster. We submit that not only the VA, but every agency of the Federal Government should be encouraged -- in fact, directed -- to "open up" and consider these proven management services as a way of using the competitive forces of the free enterprise system to assist in bringing improved quality of service with increased productivity.

ServiceMaster is the leading provider of management services to the health care community for the non-medical support departments of housekeeping, plant operations and maintenance, laundry and linen services, clinical equipment maintenance, materials management, and food service management. We currently provide our services in over 950 health care facilities, which include hospitals ranging in size from fewer than 50 beds to over 1,000 beds.

We serve all major segments of the health care community, including large university and teaching facilities; multiple hospital systems, both proprietary and not-for-profit; hospitals owned and operated by local and state governments; and local community hospitals. With the exception of United States Air Force hospitals, the only significant segment of the health care community not open to these management services is hospitals operated by agencies of the Federal Government.

The expansion of our services to over 950 health care

facilities,at a growth rate that has required our company to double in size every three years for the past 12 years, is a factor in the marketplace that cannot be ignored. This expansion is documented in the recent article in Modern Healthcare magazine of July, 1981, pgs. 73-80, ~~(attached as Exhibit 1)~~ reporting upon the growth in the number of hospitals using some sort of management or contract services.

Our service is a management service which typically is provided by our on-site manager managing the hospital's employees to perform the designated function in accordance with agreed-upon standards, at a guaranteed overall cost. We do not replace administration. We support administration, typically using the hospital's own employees and providing management, motivation, and training of those employees for an improved level of performance. It is important to note here that our service can be delivered to VA hospitals using -- not replacing -- their existing labor force, including those in the labor force who are disabled veterans. This labor force could remain on the Government payroll or it could be directly employed by ServiceMaster, depending upon the needs and requirements of the VA or any of its individual hospitals.

The benefits of our management system for hospitals include:

* improved quality and consistent delivery of service;
* cost containment and control;
* education and training for people development resulting in a motivated work force;

* improved administrative controls on support service functions through establishment of regular appraisal and review.

Cost containment is a major concern for every health care facility. ServiceMaster has consistently been able to provide management programs with improved quality at the same or reduced cost. And initial cost savings is only the beginning of our effort to help the hospital contain costs. We are constantly developing improvements in our service delivery system which provide additional savings. ServiceMaster has committed substantial resources to the applied research and development of products, equipment, and system improvements. We have the economies of scale to do the development work that no single institution and no other provider can accomplish. What are the results of these efforts? Here are just a few examples:

* We have initiated an energy management program which has resulted in substantial savings for customers of our plant operations and maintenance program. This program was cited at the national convention of the American Hospital Association. At the opening session attended by 7,000 health care professionals, ServiceMaster was commended for an energy program that reduced energy consumption by an average of 18%, a total of $5.7 million saved in energy costs. That is a reduction of 770 billion BTUs -- enough energy to power 31 one hundred-bed hospitals for a year.

* In the past four years we have introduced seven major technical improvements in our housekeeping program. The net effect of these improvements is a substantial productivity increase for hospitals we serve.

* The chemicals, cleaning products, and equipment we use in the delivery of our housekeeping management system are developed and manufactured by us. However, we are not in the business of selling products. Our business is based upon the delivery of an efficient management program. The products and equipment are used only as a tool in accomplishing an overall result. In housekeeping, for example, products and equipment represent less than 5% of total costs. Although this is a small percentage of the total, it is still important to improve our efficiency in this area. In one recent equipment innovation we succeeded in reducing by two-thirds the amount of germicidal disinfectant required for cleaning hard surface floors -- while reducing bacteria count and shortening labor time as well.

In a competitive environment we have a powerful incentive to continue to improve the benefits of our programs. Unless we establish a differential initially, there is no reason for the hospital to buy our service. Unless we go on to establish a

differential on a continuing basis, there is no reason for that hospital to continue our service. Thus, in order to establish and to continue our business, we must constantly improve. We are a service company, and we cannot rely upon patents, bricks and mortar, or the security of tradition to survive and grow. We must rely instead on customer satisfaction.

Why should not the Federal sector be open to the dynamics of these benefits? As I mentioned in my introductory remarks, the only Federal segment using hospital supportive management services is the United States Air Force system. We have had the privilege of serving in a number of these hospitals, and in addition to improving overall costs we have been able to significantly reduce employee turnover, add job skill training and education, and provide, for example, in one such facility an opportunity for over 30 housekeeping employees to earn their high school degrees. We are in a people business, and people are important and need expanded opportunities for training and education regardless of who they work for, private industry or the Federal Government.

Congressman Dan Rostenkowski, Chairman of the House Ways and Means Committee and former Chairman of the Subcommittee on Health, noted in an address given a few years ago, which was [redacted] the significant contribution ServiceMaster has made to the health care community, and he commended ServiceMaster for its efforts

in delivering a more organized and efficient supporting management program for hospitals. At that time he encouraged us to continue to participate in the process of increasing the efficiency of the health care delivery system. We believe that our appearance before you today is in furtherance of that word of encouragement.

As president of ServiceMaster and as a member of the board of the National Committee on Quality Health Care, I am interested in seeing that the Federal sector has available to it the same programs and benefits found to be effective in the private sector. It is not necessary to conduct a $10 million to $20 million survey in order for the VA to consider these benefits. The Air Force already has proven what the private sector also has found, namely that the costs of survey and analysis typically are borne by those who desire to deliver services. The competitive nature of the marketplace allows the customer to consider the best alternative -- including a fair comparison of the alternative of in-house management -- without significant cost to the institution.

We support and concur with the President's statement in signing PL9766, that the application of OMB Circular A-76 can result in substantial savings for the VA, with no degradation of patient care. We suggest that the VA undertake a pilot program, involving a responsible and responsive management firm serving a select group of VA hospitals, to determine the benefits of supporting management services for housekeeping, plant operations and maintenance,

and food service, as an alternative to the present in-house programs. The results of this pilot program should be reported to this Committee, with further consideration regarding whether such a program should have VA system-wide application.

Thank you.

Harry A. Stroh Associates, Inc.
1101 State Road
Research Park
Princeton, N.J. 08540

(609) 924-6974

November 17, 1981

TO: G.V. Montgomery, Chairman
Subcommittee on Oversight and Investigations

FROM: Raymond D. Kalpin, President
Harry A. Stroh Associates

SUBJECT: OMB CIRCULAR A-76

On behalf of Harry A. Stroh Associates, I would like to make brief testimony on OMB Circular A-76, and whether or not the private sector can provide the complete services required by Circular A-76.

Harry A. Stroh Associates have been specializing in Hospital Housekeeping Services since 1951 and in more recent years expanded into Physical Plant Management and other related services.

It is without doubt that the established firms in the private sector can provide the complete services as required. In addition, the private sector can provide these services more effectively and efficiently and in most cases at a considerable reduction in cost. Firms in the private sector are continuously involved in research to develop materials, equipment, methods, systems and procedures which will increase productivity levels. Our "Corporate Goal" in Princeton has been to offset the "Cost of Inflation" by greater "productivity levels."

The capability of the private sector providing the required services has beer successfully demonstrated in a program referred to as "Hospital Aseptic Management Services" (HAMS). HAMS was developed by the Surgeon General's Office in conjunction with the Air Force. In 1976 contracts for nine hospitals were awarded to the private sector. The number of hospitals have increased each year to a current number exceeding thirty hospitals. The program has been so successful that the Surgeon General's Office is currently requesting proposal for a similar program in "Medical Facility Real Property Maintenance Management" (MFRPMM) for a select group of hospitals.

The "HAMS" program can further support the private sector by the contract renewals. Analysis of the contract renewals will generally show that while the requirements for services increased, the contractors in the private sector were able to reduce their labor man-hours, thereby, keeping a lid on rising costs.

We thank you for the opportunity to present this testimony and assure you of our continuous support for the project.

Attachments A and B

ATTACHMENT A

BILL BRADLEY
NEW JERSEY

United States Senate
WASHINGTON, D.C. 20510

July 31, 1980

Mr. Harry Stroh
Harry A Stroh Associates
1101 State Rd.
Princeton, New Jersey 08540

Dear Mr. Stroh:

I was pleased to learn that your company has been awarded a Department of the Air Force contract to perform the medical facility housekeeping services function at Hill Air Force Base, Utah. Congratulations!

I understand that converting the services from government operation to contracted operations will save the government approximately $235,700 over the three year period of the contract. So the good news is not yours alone.

Congratulations again.

Sincerely,

Bill Bradley

Bill Bradley
United States Senator

BB/jde

Harry A. Stroh Associates, Inc.
1101 State Road
Research Park
Princeton, N.J. 08540

(609) 924-6974

ATTACHMENT B

Partial list of hospitals over 500 beds which we have served.

Name of Hospital	Type of Contract
Abington Memorial Hospital Abington, Pennsylvania	Management
Baltimore City Hospital Baltimore, Maryland	Management
Children's Medical Center Boston, Massachusetts	Management
David Grant Medical Center Fairfield, California	Full-Staff
Grace-New Haven Community Hospital New Haven, Connecticut	Management
The Hospital of the University of Pennsylvania Philadelphia, Pennsylvania	Management
Hahnemann Medical College and Hospital Philadelphia, Pennsylvania	Management
The John Hopkins Hospital Baltimore, Maryland	Management
Medical College of Virginia Richmond, Virginia	Management
Malcolm Grow Medical Center Prince George County, Maryland	Management
Roanoke Memorial Hospitals Roanoke, Virginia	Management
Sinai Hospital of Baltimore, Inc. Baltimore, Maryland	Management
Thomas Jefferson University Hospital Philadelphia, Pennsylvania	Management
Wilford Hall Medical Center San Antonio, Texas	Full-Staff

NATIONAL FEDERATION OF FEDERAL EMPLOYEES

JAMES M. PEIRCE • PRESIDENT

ABRAHAM ORLOFSKY • SECRETARY TREASURER

1016 16th St., N.W. WASHINGTON, D.C. 20036 PH: 202-862-4400

SERVING THE FEDERAL EMPLOYEE SINCE 1917

In reply refer to: HR-PT-90

November 25, 1981

HAND DELIVERED

The Honorable G.V. Montgomery
Chairman Subcommittee on Oversight
and Investigations
House Committee on Veterans' Affairs
335 Cannon House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

Enclosed is the statement by the National Federation of Federal Employees on Office of Management and Budget Circular A-76 and its application to the Veterans' Administration. I would appreciate having the statement included in the official record of the Subcommittee's hearing of November 17, 1981.

Thank you very much.

Sincerely,

James M. Peirce
President

Encl.: NFFE statement on OMB Circular A-76

Vice Presidents: Region 1, Paul C. McNaught, Woburn, Mass. • Region 2, J. Richard Hall, New York, N.Y. • Region 3, A. B. Reynolds, Panama City, Fla. • Region 4, Ray K. Sinclair, Houston, Tex. • Region 5, Prospero (Pros) Chavez, Albuquerque, N.M. • Region 6, Marlene Steffen, Vista, Cal. • Region 7, Albert W. Lampton, Richland, Wash. • Region 8, Gary W. Birino, Independence, Mo. • Region 9, Charles G. Smith, Cincinnati, Ohio

STATEMENT BY

THE NATIONAL FEDERATION OF FEDERAL EMPLOYEES

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

HOUSE COMMITTEE ON VETERANS' AFFAIRS

ON

OMB CIRCULAR A-76

AND ITS APPLICATION TO THE

VETERANS' ADMINISTRATION

November 17, 1981

Mr. Chairman and Members of the committee:

I appreciate this opportunity to present the views of the National Federation of Federal Employees on OMB Circular A-76. NFFE, which represents many employees of the Veterans' Administration, has long been concerned about Circular A-76 and the stimulus it provides for contracting out government services. We are especially concerned with its application with regard to the VA. It is my strong belief that congressional review of the circular is essential, and I commend the committee for initiating hearings on the issue.

It is incorrect to assume that a job can be performed better if contracted to the private sector. In fact, General Accounting Office reports document the rampant abuse and mismanagement of government work contracted out under the justification of A-76. The repercusssions of such mismanagement can only be adverse to the VA health care system where the very nature of its services requires competence, precision and reliability.

Since its issuance, Circular A-76 has stood at the center of each Administration's policy of contracting out government work. It has represented the movement toward reliance upon the private sector often without adequate concern over the contracted function. Private industry has become the beneficiary of a policy that is blatantly biased toward it. The circular itself states, "the government's business is not to be in business.

Where private sources are available, they should be looked to first to provide the commercial or industrial goods and services needed by the government to act on the public's behalf."

The contracting of government work has too often been in contradiction to the principles of good government: reducing government costs and preserving inherent governmental functions. Agencies have assumed virtually unlimited authority to award contracts which are not always cost-efficient. Additionally, managerial oversight of the increasing number of contracts has failed to improve, and the the general interpretation of A-76 has firmly entrenched contracting out as a national policy.

Revision of A-76 is essential. The circular should encourage reliance upon the private enterprise system to supply the needs of government only when it is not in the material interests of the government to directly provide the products and services that it uses. For exapmle, essential services which the government needs to fulfill its mission, such as the laundry, pharmaceutical or janitorial operations within VA hospitals, should remain in house.

Quality economy should also be properly considered in any decision concerning the application of A-76. Cost comparisons are vital and should be done in every case without an arbitrary cut-off. The average taxpayer would consider $100,000, the

amount below which contracts are not subject to cost comparisons, to be an enormous amount of money. To let that amount slip through the government's hands without ensuring quality economy is unacceptable. If the cost of making sure the taxpayers' money is being properly spent is too much, then keep the job in-house.

The A-76 handbook requires continuous cost comparisons for in-house projects to determine whether they can be converted to the private sector. It does not, however, require the same continuous review of work already contracted. An agency must first decide that the work could be done for 35% below a contractors' costs before a cost comparison will be done. This is inappropriate. In the first place, the 35% factor is much too high. In the second place, cost comparisons should be made equally for contractors and in-house functions. There should be no adding of 35% to keep the contract with the contractor.

Furthermore, the circular's requirement for cost comparisons should provide for detailed statements of the contracted work. Identical job requirements must be established to prevent contractors from underbidding based on reduced job responsibilities. Once again, the intent of this is self-evident in the case of VA hospitals. Unfortunately, the VA hospitals' statements of work frequently fail to adequately assess the job functions of VA employees and contain only minimal work requirements. Accurate work statements are needed to guarantee fair competition.

I would like to add as a caveat, however, that while cost comparisons are good in principle, they hold numerous disadvantages. A Contract is rewarded to the contractor who makes the lowest bid regardless of whether he pays employees lower wages. There is a greater likelihood in these cases that the employees will be less trained and possibly less competent.

A-76 should instead indicate that contractor jobs will be offered at the same salary levels and with similar benefits. Without this protection, contractors undermine Federal employee pay and benefits by submitting bids based on lower salaries which Federal employees must then accept if the contract is awarded. Moreover, should a Federal employee refuse a contractor's offer for employment at a lower salary, frequently severance pay can be withheld. Refusal of a job under these circumstances should not result in the loss of severance pay.

In addition, cost inflators are inherent within the circular, especially in the treatment of retirement costs. A-76 requires the inclusion of an arbitrary figure of 20.4% for retirement costs for the Government. This figure should be 7%, which better represents the cost of annuities. The circular merely discriminates against Federal employees by adding estimates for retirement purposes to a contractor's cost

THIS TESTIMONY IS OFFERED TO SUPPLEMENT HEARINGS HELD ON 17 NOVEMBER 1981, BY THE SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS, COMMITTEE ON VETERANS' AFFAIRS, OF THE U.S. HOUSE OF REPRESENTATIVES.

SUBMITTED BY

RUSSELL W. RICHARDSON

CHAIRMAN, COMMITTEE ON CONTRACTING OUT

SUITE 1002

1911 JEFFERSON DAVIS HIGHWAY

ARLINGTON, VA 22202

TELEPHONE: (703) 920-7640

Mr. Chairman and Honorable Members of the Subcommittee:

My name is Russell W. Richardson and I am Chairman of the Committee on Contracting Out (CoCo). This is a loose coalition of industry associations, councils, etc., united on this single issue. Our purpose is to persuade government to stick to governing, and to rely on the private sector for the commercial services and goods government requires in pursuit of its assigned role. Anything else is inefficient, burdensome and costly. Failure, over recent decades, to respect the traditional divisions of responsibility has resulted in a bloated, non-responsive and wasteful bureaucratic monster that threatens to destroy our way of life. A copy of the current membership of CoCo is attached hereto (Exhibit A), and you will see that it represents a broad spectrum of diverse private sector capability.

It is my intent to be as brief as possible while trying to shed some light of objectivity into this subject as it affects all government commercial and industrial-type activities (CITA), including those currently performed in-house by employees of the Veterans Administration.

As a starting point let me quote from a statement by Senator Cranston in connection with hearings on S.917 (PL97-66):

A-76, as it has been revised by the Carter Administration, guarantees no protections for the Federal employee and fails to provide adequate requirements for quality cost-effectiveness. It is instead an embarrasing example of private sector influence upon recent Administrations.

Medical care and benefits extended to the nation's veterans should not be damaged because of the inherent problems with A-76. The stability , knowledge and experience that VA personnel currently provide are essential to the agency's mission. A-76 should not be used as a tool to benefit private sources but should instead allow the government to offer the best service it can to meet the public's needs.

"Summarized briefly those concerns, which both Committees on Veterans' Affairs share, are: first, the substantial costs involved...estimated at as high as $29 million...are being taken from funds appropriated for the provision of health care services; second, contracting out may prove to be counterproductive to the goal of good health care and may not even be cost-effective in the long run; and, third, in the light of the March 21, 1980, opinion of the VA General Counsel concluding that the contracting out of basic medical care operations of D.M. and S. cannot be justified...legally, serious doubt exists that many of the functions being examined for purposes of their being contracted can lawfully be performed by private contracts".

The Executive Branch is presently operating under OMB Circular A-76, which was revised and updated in March of 1979 during the Carter Administration, to analyze, evaluate and execute "make or buy" decisions under an orderly and disciplined procedure designed to produce the best deal for the U.S. taxpayer, while improving or maintaining the quality of the service and the integrity of the product.

During this session of the Congress there have been numerous efforts, on behalf of local and vocal constituent minorities, to neutralize or evade the intent and purpose of A-76 for discrete areas of activity. However, is even a few of these efforts

find their way into law as separate legislation, or as appendages to other major pieces of legislation, A-76 will be effectively legislated out of existence for all practical purposes, and the taxpayer denied the very real opportunities for tax relief and improved service quality he deserves.

It should be pointed out that in FY1981 the VA let contracts for some $700 million of goods and services. Congress should be aware that the provisions of PL97-66 preclude any cost comparisons which might be appropriate to justify bringing some of this back inside. The knife cuts both ways, and neither permits the benefits inherent in the A-76 process to be realized.

Senator Cranston's point that an "estimated" $29 million must not be removed from health care funds to finance cost comparisons assures nothing except that the comfort and tranquility of the VA workforce will go along as usual, undisturbed. The Department of Defense, which has done far more than any other agency in the application of OMB Circular A-76, has produced some impressive data. In FY1979 and 1980 alone DOD contracted for 60 conversions to industry at a cost of $228 million. For this work the inhouse costs were $495.9 million. DOD saved 54% by contracting out.

In addition, it should be emphasized that, when faced with the threat of competition, affected government activities suddenly

find they can streamline and prune existing organizations to return important savings.

In FY1980 the VA made 70% of its total procurement actions on a non-competitive basis, the highest of any agency of the federal government. Would Congress deny the VA the benefits which are inevitable with the introduction of the element of competition.

Another question which invariably arises is the dedication and expertise of the federal worker, and the risk that these will be lost forever if this function is contracted out. What is lost sight of is that A-76 requires that the successful contractor give first rights of job refusal to qualified incumbents. The record shows that, historically, 85% elect to go to work for the contractor, with the majority of the rest opting for early retirement. Are these people fully qualified as long as they remain on a government payroll but immediately suspect the minute they transfer to a private payroll? Nonsense!

Another smokescreen which is conveniently raised to challenge A-76 is the charge that a private sector contractor can only be the low bidder through the simple expedient of reducing the numbers of the current workforce and, by implication, the quality of service. Any reasonably competent and objective administrator, without the constraints imposed by civil service regulations and policies, could effect immediate personnel reductions in most federal agencies without any perceptible dilution of performance.

Indeed, performance would likely show a significant improvement. GSA, the Postal Service and VA are among the more promising candidates.

And finally, with respect to Senator Cranston's concerns, I enclose as Exhibit B a statement dated November 3, 1981, by the Honorable David A. Stockman, Director of the Office of Management and Budget, to Senator S.I. Hayakawa in which Mr. Stockman clearly sets forth the savings potential that can be realized from an expanded implementation of OMB Circular A-76 throughout the Executive Branch. It would be regrettable indeed if Congress, particularly those concerned with Veterans' Affairs, continues to forbid those cost comparisons which are an essential part of the process of finding the areas where savings can be realized and passed on to the U.S. taxpayer. Many of these areas within the VA are totally unrelated to health care and medical services per se.

In support of Mr. Stockman's contentions, we have a record of over 80 separate GAO reports to the Congress, to a specific member or to an entity of the Executive Branch. These were issued between January 1972 and December 1977, inclusive, and generally dealt with various applications and opportunities involving the use of OMB Circular A-76. GAO has long advocated a broader and more orderly reliance on the competitive market place and the private sector to reduce both service costs and the uncontrolled growth of government. A list of these earlier

GAO reports is enclosed for your reference as Exhibit C. More recent reports by GAO are even more supportive of a broader use of A-76, and we would be glad to identify some of them for you.

And, finally, some observers have felt that many of the pressures which give rise to these rationales we have addressed emanate from those with a heavy stake in maintaining the status quo, the bureaucrats and advocates for the incumbent workforce. Such inputs cannot avoid the taint of self-serving personal interest. It is unfortunate that a canvass cannot be made of the patients involved, and their experiences in federal vs. private health care institutions. Thousands of private hospitals all over our country are run economically while producing the very best in health care.

If the charge is valid, that control is often lost when a private sector contractor takes over a function, and fails to perform in accordance with contractural requirements, then the real criticism belongs with those government employees administering and monitoring his performance. The tools to make him "shape up or ship out" are available and ought to be used.

In conclusion, and with respect to the third point raised by Senator Cranston's statement quoted herein, it should be a matter of grave concern to every citizen if Congress has, in

fact, decreed that basic medical care functions of the VA can only be discharged by federal employees. One of our member organizations has obtained a preliminary legal challenge on this question. A copy of this letter from the respected law firm of Arnold and Porter, dated November 5, 1981, and addressed to the National Council of Technical Service Industries, is attached as Exhibit D. We believe you will find it of interest and hope it will prove helpful in your deliberations.

The Committee on Contracting Out stands ready at any time to meet with members of the Subcommittee or its staff to explore this subject more fully and to the extent it deserves.

Thank you.

COMMITTEE ON CONTRACTING OUT EXHIBIT A
(COCO)
1911 Jefferson Davis Highway
Suite 1002
Arlington, Virginia 22202
(703) 920-7640

SUBSCRIBING ASSOCIATIONS — SEPTEMBER, 1981

AEROSPACE INDUSTRIES ASSOCIATION

* AMERICAN CONSULTING ENGINEERS COUNCIL

AMERICAN DEFENSE PREPAREDNESS ASSOCIATION

* AMERICAN ELECTRONICS ASSOCIATION

ASSOCIATED GENERAL CONTRACTORS OF AMERICA

* ASSOCIATION OF MEDIA PRODUCERS

* ASSOCIATION OF DATA PROCESSING SERVICE ORGANIZATIONS

* BUILDING SERVICE CONTRACTORS ASSOCIATION INTERNATIONAL

* CONFERENCE OF AMERICAN SMALL BUSINESS ORGANIZATIONS

COUNCIL OF NATIONAL SECURITY COMPANIES, INC.

ELECTRONIC INDUSTRIES ASSOCIATION

HELICOPTER ASSOCIATION OF AMERICA

* INFORMATION INDUSTRY ASSOCIATION

* LEGISLATIVE COUNCIL FOR PHOTOGRAMMETRY

MOTOR VEHICLE MANUFACTURERS ASSOCIATION OF THE U. S., INC.

* NATIONAL ASSOCIATION OF SERVICE CONTRACTORS

* NATIONAL AUDIO-VISUAL ASSOCIATION, INC.

* NATIONAL COUNCIL OF PROFESSIONAL SERVICES FIRMS

NATIONAL COUNCIL OF TECHNICAL SERVICE INDUSTRIES

NATIONAL SECURITY INDUSTRIAL ASSOCIATION

* NATIONAL SMALL BUSINESS ASSOCIATION/
NATIONAL SMALL BUSINESS LEGISLATIVE COUNCIL

NATIONAL TOOL & DIE ASSOCIATION

* NATIONAL UTILITY CONTRACTORS ASSOCIATION

* PRINTING INDUSTRIES OF AMERICA, INC.

* TEXTILE RENTAL SERVICES ASSOCIATION OF AMERICA

* EXCLUSIVELY OR PREDOMINANTLY SMALL BUSINESS INTERESTS

EXECUTIVE OFFICE OF THE PRESIDENT _ EXHIBIT B
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

JUL 3 1981

Honorable S. I. Hayakawa
United States Senate
Washington, D. C. 20510

Dear Sam:

On October 28, 1981, I testified before the Joint Economic Committee on the Impact of Government Competition on Small Business. My testimony centered on implementation of OMB Circular No. A-76, which sets forth the Government's policy of reliance on competitive private enterprise for commercial or industrial products and services required by the Government.

We estimate that the Government currently operates thousands of commercial or industrial activities with an annual operating cost in excess of $20 billion with a similar amount of capital investment. The vast majority of these activities has never been subject to competition. If these activities were subject to the cost comparison studies required by A-76, we estimate that as many as 154,000 personnel spaces could be converted to private sector contract operations with a 5-year cumulative savings between fiscal years 1982 and 1987 in excess of $3 billion. These savings will continue to accrue thereafter.

The potential for such savings has been recognized for a long time. Since 1955, each Administration has expressed a general policy of reliance on the private sector for services needed to support the accomplishment of agency missions. The most recent expression of this policy was published in 1979. However, the policy has been applied unevenly over these Administrations, and it is now time to make it work.

Accordingly, the Reagan Administration would welcome a clear statement of intent by the Congress to support the policy that the Government should not compete with its citizens, and should rely on the competitive private enterprise system for needed goods and services. We, therefore, enthusiastically and fully support the Senate Joint Resolution 93, which you introduced on June 22, 1981. It is an excellent means to clarify and reaffirm this as a national policy and will illustrate to the public and private sectors alike that it is truly the Government's policy to rely on the private sector for needed commercial and industrial goods and services. The Resolution, provides timely support for President Reagan's quest for a new, revitalized approach to strengthening this country's economy. Economy and efficiency in Government and reward of the private sector for initiative and productivity are necessary ingredients in our formula for economic renewal.

Sincerely,

David A. Stockman

David A. Stockman
Director

88-212 O—82——6

EXHIBIT C

GAO REPORTS DEALING WITH OMB CIRCULAR A-76

Title	Addressee	Date	Publication number
Allegations of Irregularities and Possible Conflict of Interest in Award of Contract At Vanderberg Air Force Base, California	Individual Member of Congress	1/25/72	B-174518
Cost of Using Civil Service vs. Contract Labor for Loading Containers at the Military Ocean Terminal, Bayonne, New Jersey	Congressional Subcommittee	1/25/72	B-171695
Better Controls Needed in Reviewing Selection of In-House or Contract Performance of Support Activities	Congress	3/17/72	B-158685
Review of DOD Program for Conversion of Unofficial Telephone Service at Military Installations	Secretary of Defense	6/8/72	B-158469
Cost of Using Civil Service vs. Contract Labor for Loading and Unloading the GTS Admiral William M. Callaghan at the Military Ocean Terminal, Bayonne, New Jersey	Congressional Subcommittee	6/21/72	B-171695
Alleged Conflict Between Office of Managment and Budget Circulars A-76 and A-94	Individual Member of Congress	10/17/72	B-115398

Title	Addressee	Date	Publication number
Naval Training Command Decisions to Make Instead of Buy Certain Audio/Visual Projection Systems	Individual Member of Congress	2/22/73	B-176496
Review of Small Caliber Ammunition Program Managed by the Frankford Arsenal	Secretary of Defense	3/5/73	B-146977
Review of Potential Savings by Use of In-House Operations for Milk Products	Secretary of Defense	3/22/73	B-172428
Selection and Use of Contractor for Developing a Management Information System for the Atomic Energy Commission	Congressional Committee	6/8/73	B-164105
Contracting Out Custodial Services at Norton Air Force Base, California	Individual Member of Congress	7/2/73	B-178849
Industrial Management Review of the Naval Air Research Facility, Alamede, California	Secretary of Defense	7/3/73	B-133014
Review of Temporary Lodging Project Proposed for Andrews Air Force Base, Maryland	Individual Member of Congress	7/5/73	B-169926
Potential for Greater Consolidation of the Maintenance Workload in the Military Services	Congress	7/6/73	B-178736
Better Management Needed in Civil Agencies Over Selection of In-House or Contract Performance of Support Activities	Congress	7/31/73	B-158685

Title	Addressee	Date	Publication number
Build and Charter Program for Nine Tanker Ships	Congress	8/15/73	B-174839
Study of Military Temporary Lodging Facilities and the Availability of Commercial Motels	Congressional Subcommittee	9/27/73	B-169926
Review of AEC's Use of Contractor-Furnished Employees Rather Than Federal Employees	Chairman, AEC	11/1/73	B-164105
Review of Bureau of Indian Affairs Contracts for Automatic Data Processing Management Services	Individual Member of Congress	12/6/73	B-114868
Investigation of Methods Used for Computing Overhead Rates at Fort Monmouth, New Jersey	Individual Member of Congress	11/12/73	B-172707

Title	Addressee	Date	Publication number
Transfer of Cargo Operations at the Military Ocean Terminal, Oakland, California, From Civil Service to Contract Labor	Individual Member of Congress	6/11/74	B-171695
Project REFLEX (Resource Flexibility)--A Demonstration of Management Through Use of Fiscal Controls Without Personnel Ceilings	Congress	6/21/74	B-165959
Implementation and Impact of Reductions in Civilian Employment, FY 1972	Congress	7/2/74	B-180257
The Cost of Aerospace Ground Equipment Could be Reduced	Congress	9/11/74	B-177751
Contract for Food Service Operations at Lackland Air Force Base	Individual Member of Congress	10/4/74	B-180966
The Air Force Should Review Contracting Out for Services at McGuire Air Force Base	Individual Member of Congress	11/5/74	B-158685
Agency Printing and Duplicating Operations Need Management Improvements	Congressional Committee	11/11/74	B-114829
Improvements Needed in Criteria Used by Executive Agencies in Making Cost Comparisons	Director, OMB and Administrator, GSA	11/14/74	B-163762
Contracting at Base Operations at Army, Navy, and Air Force Training Installations	Secretary of Defense	11/18/74	B-158685
Comparing Costs of Marking Airfields: Air Force vs. Contract	Individual Member of Congress	12/13/74	B-178569 LCD-74-331

Title	Addressee	Date	Publication number
Reduction in Force vs. Contracting at Picatinny Arsenal	Individual Member of Congress	1/7/75	B-159685 FPCD-75-127
Survey of Industrial Management Activities at Rock Island Arsenal	Secretary of the Army	1/20/75	B-159896 LCD-75-427
Financial Operations of the Five Service Academies	Congress	2/6/75	B-159219 FPCD-75-117
Inquiry into Need for Family Housing at Ft. Eustis and Langley AFB	Individual Member of Congress	2/14/75	B-169926 LCD-75-322
Patrick Air Force Base Food Service Cost Comparison Study	Individual Member of Congress	5/8/75	B-182672 LCD-75-438
Use of Temporary Lodging Units at the Newport Naval Base, Rhode Island	Individual Member of Congress	5/15/75	B-169926 LCD-75-319
Improving the Pay Determination Process for Federal Blue-Collar Employees	Congress	6/3/75	B-164515 FPCD-75-122
Ways of Increasing Productivity in the Maintenance of Commercial-Type Vehicles	Administrator, GSA, Secreatry of Defense Postmaster General	6/24/75	B-161340 LCD-75-421
Savings Available by Contracting for Supply Support Services at the Eastern Test Range	Individual Members of Congress	8/18/75	B-146866 FPCD-76-5

Title	Addressee	Date	Publication number
Practices in Providing Cleaning and Guarding Services in Federal Buildings	Congressional Committee	8/18/75	B-133150 LCD-75-337
Office of Education Contracts With Consultants, Experts, and Consulting Organizations	Individual Member of Congress	8/28/75	B-164031(1) MWD-76-11
Army's Reduction-in-Force at Picatinny Arsenal, Dover, New Jersey	Individual Member of Congress	9/9/75	B-158685 FPCD-76-11
Examination of the Announced Closure of Frankford Arsenal	Individual Member of Congress	9/23/75	B-172707 LCD-76-305
Reduction of Civilian Personnel At New London, Connecticut, Naval Installations	Individual Member of Congress	11/4/75	B-159835 FPCD-76-22
Tugboat Operations in The Navy	Secretary of the Navy	11/24/75	B-133170 LCD-76-419
Navy Aircraft Overhaul Depots Could be More Productive	Congress	12/23/75	B-133014 LCD-75-432
Use of Commercial Facilities for the Maintenance of Postal Vehicles	Congressional Subcommittee	12/23/75	B-114874 GGD-76-30

Title	Addressee	Date	Publication number
The Air Force Should Use Both Contract and In-House Services for Maintaining Military Family Housing at Dover Air Force Base	Individual Member of Congress	1/20/76	B-184715 FPCD-76-34
Using Government vs. Commercial Facilities for Storing Military Personnel Household Goods	Secretary of Defense	1/28/76	B-146779 LCD-76-210
Military Traffic Management Command's Plans to Rely on Commercial Industry	Individual Member of Congress	2/11/76	B-171695 LCD-76-216
Comparison of Cost of Having Medicare Forms Processed by Contractors vs. In-House	Individual Member of Congress	3/1/76	B-164031 MWD-76-87
Navy Proposal to Contract-Out Work at Pt. Mugu	Individual Member of Congress	4/7/76	B-165959 FPCD-76-52
Review of GSA's Management of Federal Data Processing Centers	Administrator GSA	4/7/76	LCD-76-129
Air Force's Decision to Contract Out Photographic Activities	Individual Member of Congress	5/20/76	FPCD-76-63 B-162902
Survey of Maintenance of Construction and Rail Equipment in the Army	Secretary of Defense	6/3/76	B-162313 LCD-76-446
Observation For Improving Depot-Level Maintenance Construction in The Department of Defense	Secretary of Defense	6/7/76	B-162839 LCD-76-432
ERDA Contracting for Various Energy-Related Planning and Analysis Services	Congressional Subcommittee	9/21/76	B-186105 EMD-76-11

Title	Addressee	Date	Publication number
27 Years' Experience With Defense Industrial Funds	Congress	10/5/76	B-159896 FGMSD-76-51
Government vs. Commercial Facilities for Storing Military Personnel Household Goods	Individual Member of Congress	10/6/76	B-146779 LCD-76-245
Followup on Airfield Marking Operations	Individual Member of Congress	10/8/76	B-178560 LCD-76-354
Comments Concerning Governmental Warehouses for Storing Household Goods	Ass't Sec. of Defense	10/18/76	B-146779 LCD-76-241
Should Aircraft Depot Maintenance be In-House or Contracted? Controls and Revised Criteria Needed	Secretary of Defense	10/20/76	B-162832 FPCD-76-49
Proposal to Contract Out All Cargo Handling at the Military Terminal, Bayonne, New Jersey	Individual Member of Congress	10/22/76	B-168700 LCD-76-350
Report Regarding the Action of OMB to Greatly Expand the Amount of Contracting Out of Functions New Performed In-House by Civil Service Employees	Individual Member of Congress	11/5/76	B-158685 PSAD-77-7
Report Regarding the Action of OMB to Greatly Expand the Amount of Contracting Out of Functions New Performed In-House by Civil Service Employees	Individual Member of Congress	11/5/76	B-158685 PSAD-77-6
Alternatives In Controlling Department of Defense Manpower Costs	Congress	11/12/76	B-165959 PAD-77-8
Contracting for Navy Ship Repair and Overhaul--Need for Change	Congress	12/10/76	B-133170 PSAD-77-47

Title	Addressee	Date	Publication number
Contracting Out of Functions Previously Performed In-House	Individual Member of Congress	2/16/77	B-158685 PSAD-77-79
Government Printing Operation Improvements Since 1974	Congress	2/22/77	B-114829 LCD-77-408
Identification of Procurement Practices Needing Change	Congressional Committee	2/22/77	B-160725
Evaluation of Forest Service Plans for Carrying Out Activities of the Stockton, Calif., Regional Equipment Depot	Individual Member of Congress	3/23/77	B-125053 CED-77-55
How to Improve Procedures for Deciding Between Contractor and In-House Military Base Support Services	ecretary of Defense	3/28/77	B-158685 LCD-76-347
Comments Concerning Actions at the Military Ocean Terminal at Bayonne, New Jersey	Individual Member of Congress	4/25/77	B-168700 LCE-77-318
What Defense Says About Issues In Defense Manpower Commission Report--A Summary	Congress	5/3/77	B-184980 FPCD-77-40
Government Printing Office Production and Management Controls--Improvement Opportunities	Congress	5/4/77	B-114829 LCD-77-410
Reporting, Staffing, And Other Changes Would Enhance The Internal Audit Function In The Department of Commerce	Secretary of Commerce	6/1/77	B-160759 CED-77-58
Personnel Ceilings--A Barrier to Effective Manpower Management	Congress	6/2/77	B-165959 FPCD-76-88

Title	Addressee	Date	Publication number
Contracting Out Services at Military Bases in New York State	Individual Member of Congress	6/13/77	B- None
Potential for Contracting Selected Operations at the Air Force Academy Cadet Dining Hall	Individual Member of Congress	6/20/77	B-159219 FPCD-77-57
Review of Navy Contracting Procedures and Decision to Overhaul Ship Equipment Using Contractor Rather Than Naval Shipyard Employees	Individual Member of Congress	8/11/77	B-146889 PSAD-77-149
The Navy's Intermediate Ship Maintenance Program Can Be Improved	Congress	9/23/77	B-133170 LCD-77-412
Inadequate Methods Used to Account for and Recover Personnel Costs of the Foreign Military Sales Program	Congressional Committee	10/21/77	B-165731 FGMSD-77-22
The Five Service Academies-A follow-Up Report	Congress	11/77	FPCD-77-78
Improvements are Needed in Managing Aircraft Used by Federal Civilian Agencies	Congress	12/22/77	B-164497 LCD-77-430

EXHIBIT D

ARNOLD & PORTER

CABLE: "ARFOR"
TELECOPIER: 202 872-6720
TELEX: 89-2733

1200 NEW HAMPSHIRE AVENUE, N.W.
WASHINGTON, D.C. 20036
202 872-6700

1660 LINCOLN STREET
DENVER, COLORADO 80264
303 832-2900

STEPHEN M. SACKS
DIRECT LINE: 202) 872-6681

November 3, 1981

Dr. George A. Daoust
Executive Director
National Council of Technical
Service Industries
1850 K Street, N.W., Suite 1190
Washington, D.C. 20006

Dear George:

You have asked for our opinion as to whether a legal opinion issued by Guy H. McMichael, III, General Counsel of the Veterans Administration, to the Chief Medical Director of the Veterans Administration with respect to the contracting out of certain functions by the Department of Medicine and Surgery ("DM&S") is correct in light of the policies and procedures set forth in Office of Management and Budget Circular A-76. We have considered this opinion, as well as the legal authority cited by the VA General Counsel in his memorandum, and wanted to advise you that, in our opinion, the opinion of the VA General Counsel is an incorrect application of OMB Circular A-76.

The legal opinion by General Counsel McMichael takes the position that certain statutes dealing with missions and functions of the VA in the area of health care, as well as statutes dealing with the employment of civil servants, provide that the Department of Medicine and Surgery must perform all of its functions in house and cannot contract out any of such functions. It is interesting that, in reaching this conclusion, no specific provisions of these statutes are cited. Instead, the General Counsel has taken the position that, because statutes specify missions and functions for DM&S and certain other statutes deal with employment of civil servants by the VA, Congress intended there to be no contracting out of DM&S functions.

We disagree. Certainly, if Congress had provided a bar on contracting out (which Congress frequently does in certain specified circumstances), OMB Circular A-76 could not override that Congressional enactment. But, in the absence of such specified statutory language, we do not believe that the conclusions reached by the General Counsel with respect to the VA statutes is correct. Certainly, every federal regulation has statutes providing for the employment of civil servants. These statutes have expressly been held by numerous courts not to bar appropriate contracting out even where the functions performed pursuant to contract are similar to those performed by civil servants. Similarly, all federal agencies have statutes similar to those pertaining to DM&S which authorize those agencies to perform their basic missions. However, these statutes do not require that these missions be performed in one manner or another. Instead, resolution of that question is left to the discretion of Executive Branch personnel working under policy directives established by the President.

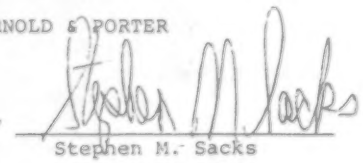
OMB Circular A-76, as revised, sets forth the clear policy of the Executive Branch with respect to the performance of functions by federal agencies. There is no mention in that circular of any exemption for the kinds of activities performed by DM&S. Indeed, Attachment A to Circular A-76, as revised on March 29, 1979, specifically lists a wide variety of health services, including "surgical, medical, dental and psychiatric care" and "hospitalization, outpatient, and nursing care" as "commercial and industrial activities" specifically covered by the policies in Circular A-76. As a result, many agencies have routinely contracted out medical functions where the other tests in Circular A-76 and its implementing regulations have been met.

ARNOLD & PORTER

Given the lack of any exemption in VA statutes, the clear policies in OMB Circular A-76 apply in our opinion to DM&S and mandate the use of contracting out where the other standards set forth in the circular have been met. For the foregoing reasons, we strongly disagree with the opinion issued by General Counsel McMichael with respect to the contracting out of functions by DM&S.

Sincerely,

ARNOLD & PORTER

By 
Stephen M. Sacks

CHAMBER OF COMMERCE
OF THE
UNITED STATES OF AMERICA

HILTON DAVIS
VICE PRESIDENT
LEGISLATIVE AND POLITICAL AFFAIRS

1615 H STREET, N.W.
WASHINGTON, D.C. 20062
202/659-6140

November 17, 1981

The Honorable G.V. Montgomery, Chairman
Subcommittee on Oversight and
Investigations
Committee on Veterans' Affairs
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

On behalf of the Chamber of Commerce of the United States and its over 200,000 members, I wish to express our views on Office of Management and Budget (OMB) Circular A-76 and its application to the provision of medical care by the Veterans Administration (VA).

We are greatly concerned by the provision in Title VI, Section 601 of the Veterans' Compensation Amendments of 1981 (P.L. 97-66), signed into law on October 16, 1981. We, like the Reagan Administration, find the provision very troublesome because it precludes the VA from conducting OMB Circular A-76 cost comparisons to determine the most economical mode of operation -- i.e., a contract or use of civil service employees. According to Administration estimates, "the application of this Circular to the VA's support-type hospital functions can result in an annual savings of approximately $140 million, with no degradation in patient care." We agree.

Moreover, we take issue with the VA General Counsel's "legal opinion" in this matter -- i.e., VA's Department of Medicine and Surgery (DM&S) must perform all of its functions in-house and cannot contract out any of these functions. As we see it, Circular A-76 clearly applies to DM&S and mandates the use of contracting out where the other standards set forth in the Circular have been met. In fact, Attachment A to Circular A-76, as revised on March 29, 1979, specifically lists a wide variety of health services as "commercial and industrial-type activities" specifically covered by the Circular. Consequently, other agencies, such as the National Aeronautics and Space Administration, the Department of Defense and the Department of Health and Human Services, have contracted out medical functions. Therefore, in the absence of specific statutory language exempting VA, we conclude that the clear policies of Circular A-76 apply to VA and DM&S.

The time has come to stop taking billions of dollars of work away from businessess, large and small -- those who pay a large share of America's taxes -- and to stop giving that work to federal employees whose facilities and salaries are paid for with those tax dollars.

I will appreciate your consideration of our views, and I respectfully request that our letter and the enclosed statement on government competition be included in the hearings' record. The enclosed statement outlines the U.S. Chamber's strong support for vigorous implementation of Circular A-76 and government reliance on the private sector for needed goods and services.

Cordially,

Hilton Davis

Enclosure

cc: Committee Members
Jack McDonell, Majority Counsel
Rufus Wilson, Minority Counsel

DEMOCRATS
G. V. (SONNY) MONTGOMERY, MISS.
DON EDWARDS, CALIF.
GEORGE E. DANIELSON, CALIF.
JACK BRINKLEY, GA.
RONALD M. MOTTL, OHIO
ROBERT W. EDGAR, PA.
SAM B. HALL, JR., TEX.
DOUGLAS APPLEGATE, OHIO
MARVIN LEATH, TEX.
WILLIAM HILL BONER, TENN.
RICHARD C. SHELBY, ALA.
DAN MICA, FLA.
THOMAS A. DASCHLE, S. DAK.
BOB STUMP, ARIZ.
PAUL BARNES, TEX.
AUSTIN J. MURPHY, PA.
BYRON L. DORGAN, N. DAK.
ANTONIO B. WON PAT, GUAM

MAGE G. FLEMING
CHIEF COUNSEL AND STAFF DIRECTOR

NINETY-SEVENTH CONGRESS

G. V. (SONNY) MONTGOMERY
CHAIRMAN

U.S. House of Representatives
COMMITTEE ON VETERANS' AFFAIRS
333 CANNON HOUSE OFFICE BUILDING
Washington, D.C. 20515

November 30, 1981

REPUBLICANS
JOHN PAUL HAMMERSCHMIDT, ARK.
MARGARET M. HECKLER, MASS.
CHALMERS P. WYLIE, OHIO
ELDON RUDD, ARIZ.
HAROLD S. SAWYER, MICH.
OSMAN S. SOLOMON, N.Y.
JIM JEFFORDS, KANS.
BOB MC EWEN, OHIO
JIM BUNN, MICH.
CHRIS SMITH, N.J.
ALBERT LEE SMITH, ALA.
SIDNEY SMITH, OREG.
MARK D. SILJANDER, MICH.

Mr. Hilton Davis, Vice President
Legislative & Political Affairs
Chamber of Commerce of the United States
1615 H Street, N. W.
Washington, D. C. 20062

Dear Mr. Davis:

Thank you for your letter of November 17th regarding Office of Management and Budget Circular A-76, "Policies for Acquiring Commercial or Industrial Products and Services Needed by the Government." As requested, your correspondence, with the attached statement, will be made a part of the Subcommittee on Oversight and Investigations' November 17th hearing record.

There appears to be some misunderstanding regarding your interpretation of Public Law 97-66. The Congress has not precluded the Veterans' Administration from conducting the cost comparison studies required by OMB Circular A-76. The purpose of Section 601 of that law is to preclude the VA from using funds appropriated for medical care, medical and prosthetic research and medical administration and miscellaneous operating expenses to carry out these studies. The Committee firmly believes that medical care appropriations should be used for their prescribed purpose--the delivery of health care to our Nation's veterans. We remain steadfast in our belief that funds for the conduct of such cost comparison studies should be requested in a separate appropriation. I do not believe that the estimated $10 million cost to conduct the initial studies should be funded by sacrificing our veterans' health care. I also question your statement, "According to Administration estimates, 'the application of this Circular to the VA's support-type hospital functions can result in an annual savings of approximately $140 million, with no degradation in patient care'." At no time during the three Circular A-76 hearings recently conducted by our Committee did Administration officials mention any estimate of cost savings of the magnitude you quote. I would be most interested to receive any documentation that you may have which would support such savings.

As you may know, the VA already has the authority under title 38, United States Code, to contract out for services needed. To quote the VA Assistant Deputy Administrator for Procurement and Supply, Mr. Clyde Cook, during the October 20th hearing: "....in a procurement budget a bit over $2 billion, approximately $700 million is for services classified as commercial/industrial." We have given the VA authority to contract out because we believe it to be a valuable and cost effective management tool.

88-212 O—82——7

You mention that the VA General Counsel's legal opinion on OMB Circular A-76 requires that the Department of Medicine and Surgery must perform all of its functions in-house and cannot contract out for any of these functions. Again, there appears to be some misunderstanding. For your information, quoted below is the statement of Mr. Donald Sowle, Administrator of OMB's Office of Federal Procurement Policy, before the Committee on October 20th:

> "In the case of the VA, their General Counsel, in an opinion dated March 21, 1980, concluded that contracting out direct patient care is precluded by law and therefore must be performed by government personnel. However, their counsel also concluded that support activities not directly related to patient care are subject to the provisions of the Circular. I would like to state that OMB supports this position."

The Committee on Veterans' Affairs will not allow the direct health care of our veterans to be contracted out. We have concluded on numerous occasions that contracting out of direct health care is not cost effective. In fact, it costs the government more. It is important to note that a recent VA study of a comparison of 1980 figures for health care delivered in VA hospitals versus private hospitals shows that VA medical care is 18.3 to 22.5 percent less expensive. This means it would have cost the taxpayers $458 to $556 million more to send veterans to private hospitals for treatment in 1980. This is a substantial savings for all taxpayers and significantly different from the costly Federal health care programs such as medicare.

The Committee does not believe that in this time of tight budgets for VA health care, with the aging veteran population putting extra demands on the ability of the VA to deliver quality health care, funds should be taken from that austere budget to conduct administrative cost studies. Those monies should be requested separately. As pointed out, the VA does have the authority under title 38, United States Code, to contract out and we believe it should be left to the hospital director's discretion to convert to contract when it is cost effective and maintains the quality of health care delivered in his hospital.

Your interest in the welfare of our Nation's veterans is appreciated.

Sincerely,

G. V. (SONNY) MONTGOMERY
Chairman

STATEMENT
on
COMPETITION IN HEALTH CARE
before the
SUBCOMMITTEE ON HEALTH
of the
HOUSE WAYS AND MEANS COMMITTEE
for the
CHAMBER OF COMMERCE OF THE UNITED STATES
by
Robert A. Carpenter
October 2, 1981

Mr. Chairman: My name is Robert Carpenter. I am Manager of Health Care Cost Containment at Republic Steel Corporation in Cleveland, Ohio. I am also a member of the Greater Cleveland Coalition on Health Care Cost Effectiveness, one of 60 business coalitions on health action located around the country. I appear here today as a member of the U.S. Chamber's Health Care Committee, accompanied by Jan Peter Ozga, the Chamber's Director of Health Care.

We are pleased to be part of this panel assembled to express its views on competition in health care. This subject has become quite popular and this committee is to be commended for providing a forum for discussion, especially for those most affected, American employers. We oppose competition legislation as written and believe that voluntary efforts to instill more competition in health care will be more effective than the competitive model's regulatory approach.

Problem: Rising Health Costs

Health care costs continue to soar and strain the public's ability to finance these services. In 1981, the nation's total annual health care bill may total one quarter of a trillion dollars or about 10% of the gross national product. Expenditures for medicare are doubling every five years and, without

new sources of revenues or reduction in services, this program will be bankrupt before the end of this decade. The medicaid program poses equally stiff challenges for the states. Employers, who account for about 40 percent of all private health expenditures, also search for answers to their rising costs.

The Causes of the Problem

There are many factors contributing to the soaring costs of health care, including:

- better and more costly health services, e.g., innovations in medical equipment and technology;
- malpractice insurance and defensive medicine practices are conservatively estimated to be about 6 percent of the total health care bill;
- inefficiency in the delivery of services for which little or no economic sanctions exist; and,
- overutilization of the available services as a result of demand stimulated by medicare, medicaid and the incentives inherent in fee for service, cost reimbursement and third party insurance which typifies the health care system.

Thus, the competitive model address only one part of the problem -- overutilization fueled by subsidized health insurance -- and it is questionable whether such an approach will have the intended effect of containing health costs.

Competition Tax Incentives Rationale

Proponents of the competition model claim that the reason health care costs are so high is that so many people are using health services, in many cases indiscriminately. Such utilization is encouraged by health insurance, which pays for about 90 percent of all hospital costs and 66 percent of physician fees. Thus, the full cost of such services is masked by a third party.

Insurance is so widely available mainly because the tax laws allow employers to deduct health insurance premiums as a business expense and for employees to receive such benefits as tax-free compensation. In addition, up to $150 of health insurance premiums paid by the individual may be directly deducted on the federal individual income tax. The remaining cost of health insurance premiums paid by the individual may be included with other medical expenses for those who itemize deductions. Finally, out-of-pocket medical costs exceeding three percent of adjusted gross income can be deducted. According to the Congressional Budget Office, in fiscal year 1980, these tax deductions collectively amounted to $14.5 billion, $9.6 billion (66%) of which relates to employer contributions.

Proponents argue that a limit should be placed on how much can be spent on health insurance premiums. Less inexpensive plans will emerge with employees sharing more of the cost. If employers were required to offer three or more plans with varying benefits and costs, and if employees were given a rebate if they chose less expensive plans, employees might not overinsure. Further, for plans to be qualified for any deductions, they would have to

include certain minimum benefits, such as catastrophic coverage and coverage for periods of unemployment.

Six proposals to promote competition in health care incorporating the above rationale were introduced into the 96th Congress. Three of these were re-introduced into this Congress. All are summarized in Attachment A.

Chamber Position on Competition Model

The U.S. Chamber supports the development of a more cost effective, competitive health care system that will enable all Americans to have access to quality care at affordable prices. More competition should have the same effect on health care that it has on the rest of the economy. It should provide choices to buyers, stimulate innnovation by sellers, and ultimately result in more stabilized costs for both.

However, the competition model--despite its good intentions--will not achieve these objectives and may be counterproductive to the goal of an improved health care system. Indeed, it appears to be a contradiction of terms to attempt to "regulate competition," when market forces best achieve this objective. Moreover, it appears that this legislation is an attempt to regulate the health care industry through employers, with employers bearing the lion's share of the burden while realizing very little, if any, benefits. An analysis of the major features of this type of legislation will illustrate these points.

Limit on Tax Free Benefits

The competition model would set a cap on the amount employers could contribute to employee health benefits, above which the contribution would be considered taxable income to the employee. The presumption is that establishing a limit would encourage employers and insurers, in turn, to develop less expensive choices of health care plans and allow employees to select among these choices. Yet, experience suggests that employees would elect to receive the health benefit and be taxed rather than forego the benefit. Employee selection of group life insurance coverage is a case in point, since employees are now taxed for that part of the premium paid by the employer for coverage in excess of $50,000.

A single national tax cap also fails to recognize that health care costs and, correspondingly, health care plans vary throughout the country and among different age groups. For example, one large manufacturing company pays twice as much for the same set of benefits in one area of the country than it does in another. Thus, a single national limit on tax free employer contributions would be inequitable. A limit which varies by age, area, and other factors would be more equitable but difficult to administer by the employer and the Internal Revenue Service. Too, a single national cap would discriminate against workers in certain areas and against older workers. Indeed, such a provision could discourage employers from hiring older workers.

Limiting tax free employer contributions would increase taxes for employees who receive benefits above the limit, which will happen under

numerous union contracts. Yet, making employees "whole"--exempt from bearing any cost of benefits--is a specific provision of various union contracts.

Establishing such an upper limit could reduce employer incentives to contain costs. Employee wellness programs and possibly self-insurance programs are two cases in point, since they may not be considered qualified plans. Although, in the short-term, these types of programs could cost more and exceed the limit, their long-term effects could result in relatively lower costs.

Establishing a single limit may jeopardize other areas of non-wage compensation, such as pensions, by subjecting such benefit contributions to taxation. This would discourage employers and employees from creating sound retirement programs. The same could be true for accident plans, disability plans, etc.

In short, establishing a national tax-free limit on employer-paid benefits will complicate an already complex tax code with questionable and possibly counterproductive results. Clearly, there is the possibility of higher costs to employers and employees, without creating a more competitive health care market or maintaining and improving the health of employees, their dependents which is the real goal of the health system.

Multiple Choices, Uniform Contributions, and Rebates

Several other features common to the competitive model are the requirements that employers offer several choices of health care plans, that employers pay the same amount for each plan regardless of cost, and that employees who select any plan other than the highest price option would receive the difference as a rebate. The rationale for these features is that employees will have the option of selecting among a variety of health plans and will be rewarded for not overinsuring.

There already exists federal and state laws requiring most employers to offer choices of health care plans. For example, P.L. 93-222, as amended, requires that all employers with 25 or more employees offer a health maintenance organization (HMO) as an option to conventional health insurance. Many employers are not only following the letter of the law but have gone beyond and are offering several HMOs. Another law is not needed for this purpose.

Having employers contribute the same amount, no matter what the choice of health care plan, is an effective cost containment strategy endorsed by the Chamber. But mandating this feature is an intrusion into the right of employers and employees to bargain for the type and amount of benefits they want and the price they are willing to pay for them. Again, legislation is not necessary for this kind of arrangement.

Another counterproductive result of high and low options is the potential for adverse selection. For example, persons most in need of health care would be required to pay a greater portion of their health service costs. Also, certain comprehensive plan options (e.g., HMOs) may attract so many high risk individuals that they would be unable to compete with other plans. Thus, this approach would be counter to the purpose of the competition model.

Rebates to employees could also increase employer costs, especially for many employers who pay employee benefit premiums in full. In addition, rebates could diminish business' growing support for alternative health care plans, such as HMOs, by having to transfer HMO premium savings from the employer to employee. In addition, to compensate for younger employees choosing low cost plans, it could be advisable to compute an age factor into rebates. This would, of course, mean additional administrative problems, reduce the number of employees who select low cost plans, and introduce at least the perception of age discrimination into the health plan.

Minimum Benefits: Catastrophic and Continuous

Other features common to all competition plans are some sort of minimum benefits, the two most prevalent of which are catastrophic coverage and coverage during periods of temporary unemployment. Again, federal legislation mandating such benefits is unnecessary, given the current level of benefits provided voluntarily by employers.

For example, in 1979, over 93 percent of all new group policies written for health care included a major medical provision that paid $100,000 or more

for catastrophic bills. A federal law requiring such coverage would simply add costs for reporting and administration.

Continuous coverage or coverage during periods of temporary unemployment is another common provision of most plans made available by large and medium size employers. However, mandating such coverage for all firms could have severe economic consequences for small firms and those engaged in retail trade. For instance, it is possible, given the high turnover among retail firms, that more former than present employees would be covered under an employer's plan. Such a situation would simply be unfair to any business.

In summary, employers aggregate premium and rebate cost may increase even if the rebate amounts are adjusted by age and area. Wages and costs of other plans may also increase. In addition, some bills greatly diminish the role of the employer to negotiate, purchase, manage and administer a good health plan for employees. Too, some proposals create new federal bureaucracies and impose increased administrative burdens on employers. Such a situation is clearly counter to the mood of the country which elected the present Administration and Congress in the hope that such intrusion and burdens would be eliminated or at least alleviated.

According to Lawrence B. Huston, Jr., Assistant Vice President, Aetna Insurance Company, "Rather than rushing into legislation based on theory, we should test the theory. <u>If</u> part or all of the <u>theory proves out</u>, we can move quickly to implementation. And in fact we <u>may not even need federal</u>

legislation, because employers and insurers will voluntarily adopt some or all of these proven pro competition consumer choice theories. But if part or all of the theory proves invalid, we will avoid costly precipitous changes with minimal benefits."(Emphasis added.)

Alternative: Voluntary Action

In opposing the methodology, if not the concept, of "competition health legislation," the Chamber remains steadfast in its support for improving the health care system, including finding ways to contain its rising costs.

This interest was demonstrated over a decade ago when our Economic Policy Department highlighted various trends and developments in a white paper. This paper underscored the need for the private sector to monitor and evaluate the effectiveness of public health programs such as Medicare and Medicaid, as well as private health insurance plans.

This report was followed in the early 1970s by creation of the Chamber's Health Care Committee, which recommends policy on health care issues to the Chamber's Board of Directors.

By the middle of the 1970s, interest in national health insurance had grown, only to be tempered by a concern for rising health care costs. Clearly, the former had to be controlled before any discussion of the latter could be considered. At this same time, the Chamber decided to conduct its own investigation into the reason for rising health care costs and to determine

how they could be contained. Accordingly, it undertook a comprehensive study of the issue that eventually resulted in its widely acclaimed Health Action program. The basis for this program is a series of action-oriented monographs that explains in what ways business is involved in health care and how it can contribute to improving health while containing cost.

The Chamber's Health Action program was implemented in early 1979. Since that time, over 60 local business coalitions for health action have been formed, at least 25 percent of which are sponsored by local or state chambers of commerce. These coalitions have a variety of memberships, sponsors and activities. However, all share at least one thing in common: they have been formed for the express purpose of seeking ways to help purchasers of health care services improve health care and contain costs voluntarily.

It must be noted that all of these organizations, the number of which may double by the end of 1982, have been formed and are operating without governmental intervention or funding. They are the epitome of the principle that local problems respond best to locally developed solutions, since the developers have a major vested interest in these solutions.

The Chamber is currently involved in a project to help promote the growth and development of business coalitions, which will help them exchange their successes and failures with other groups or communities that are seeking to develop similar organizations. Part of this activity will help coalitions redesign health care benefits, become involved in health care alternatives,

establish employer health education programs, and become more effective health planners, both on health planning agencies and hospital boards.

All of this activity underscores the need for the private sector to work together to find ways of containing rising health care costs, without resorting to governmental intervention including price controls or legislation that mandates benefits or limits such benefits through changes in the tax code.

Conclusion

Competition exists only when buyers and sellers are free to negotiate for products and services. Better purchaser and consumer awareness of health services and its costs will help competition emerge in health care. Federal legislation requiring competition is a contradiction in terms. Such legislation also could increase, rather than contain, costs as well as have the overall effect of reducing the number of Americans protected from health care costs.

A better alternative is to create a climate in which private action is allowed to flourish. This does not require any legislation but merely the support of the private and public sectors to work together to find voluntary methods of containing costs, such as through the coalition approach.

Perhaps the ultimate competition would be among the various business coalitions to develop various strategies to solve the vexing problem of rising health care costs. The U.S. Chamber and many other segments of the private sector are committed to helping this kind of competition thrive.

Attachment A

MAJOR PROPOSALS FOR COMPETITION/TAX INCENTIVE HEALTH INSURANCE

HEALTH INSURANCE LEGISLATION: Name, Number and Primary Sponsors	COMPREHENSIVE HEALTH CARE REFORM ACT S. 139 Hatch (R-UT)	HEALTH INCENTIVES REFORM ACT S. 433 Durenberger (R-MN)	HEALTH COST RESTRAINT ACT Ways and Means Committee bill	MEDICAL EXPENSE PROTECTION ACT Martin (R-NC)	NATIONAL HEALTH CARE REFORM ACT H.R. 850 Gephardt (D-MO)	CONSUMER HEALTH EXPENSE CONTROL ACT Jones (D-OK)
Provisions of Interest to Employers	NOTE: None of these plans require any employer to provide health insurance to employees, *unless* they wish to deduct premiums as business expense and/or they wish to provide health benefits tax free to employees.					
EMPLOYER PARTICIPATION	All employers must offer plan with 25% copayment. Employers with *50* or more employees must provide catastrophic and preventative plans. Employers with *200* or more employees must offer a choice of 3 plans.	Employers with *100* or more employers must offer *3* plans written by *3* different carriers or prepaid health plans.	All employers who provide family health insurance whose premiums are *$75* or more per month.	ALL EMPLOYERS	ALL EMPLOYERS	ALL EMPLOYERS
EMPLOYEE PARTICIPATION	Employees not required to accept coverage.	Employees not required to accept coverage.	Employees not required to accept coverage.	Employees not required to accept coverage. *But*, if choose government plan, would pay 50% higher deductible than other eligibles.	Employees not required to accept coverage.	Employees not required to accept coverage. *But*, if choose government plan, would pay 100% higher deductible than other eligibles.
TYPES OF BENEFITS MANDATED						
• Basic	No	Yes	Yes	No	No	No
• Preventive	Yes	No	No	No	No	No
• Catastrophic	Yes	Yes	Yes	Yes	Yes	Yes
• Annual Deductible	20% of income	$3,500	$2,000	$2,500	$2,900	$3,500
• Continuous Coverage	Yes, 6 months	Yes, 1 month	NO MANDATE	Yes, 3 months	Yes, 3 months	May convert.
CHOICES OF PLANS All plans *encourage* choices through "REBATES" (See below)	No mandates but all plans must have 25% copayment for hospital services.	3 different plans written by 3 different carriers must be offered.	No mandate but HMO (group, staff, or IPA) or low cost insurance plan must be offered.	No mandate beyond one qualified plan.	No mandate beyond one qualified plan.	No mandate beyond one qualified plan.
FINANCING AND TAX LIMITATIONS						
• Tax Free Monthly Premium Limit	None specified	$125	$120	$120	Equivalent to average area premium of plans actually selected.	$100
• Premium Shared	No	No	No	Yes, employer pays 50% of least expensive plan.	Optional	Yes, employer pays 50% of least expensive plan.
• Equal Employer Contribution	Yes	Yes	Yes (approximately)	Yes	Yes	Yes (approximately)
TAX LIABILITY EMPLOYERS	*Employers*–premium contribution not deductible if paid for non-qualified plans.	*Employers*–no penalty	*Employers*–no penalty	*Employers*–premium contribution not deductible if paid for non-qualified plans.	*Employers*–no penalty	*Employers*–no penalty
EMPLOYEES	*Employees*–premiums taxed as income if paid for non-qualified health plans.	*Employees*–premiums taxed as income if exceed limit, paid for non-qualified plans, or 3 plans not offered.	*Employees*–premiums taxed as income if exceed limit or paid for non-qualified health plans.	*Employees*–premiums taxed as income if exceed limit or paid for non-qualified health plans.	*Employees*–premiums taxed as income if exceed limit or paid for non-qualified health care plan.	*Employees*–premiums taxed as income if exceed limit or paid for non-qualified plans.
REBATES (difference between employer's contribution and cost of plan selected by employee)	*Employer*–No *Employee*–Yes, Tax free	*Employer*–No *Employee*–Yes, Subject to all wage taxes.	*Employer*–No *Employee*–Yes, Subject to income but not FICA or FUTA taxes.	*Employer*–Yes (25%) *Employee*–Yes (75%) Tax free up to $100 per year; excess subject to income but not FICA or FUTA taxes.	*Employer*–No *Employee*–Yes, Tax free up to $500 per year; excess subject to income but not taxes or FUTA. Tax credits also available.	*Employer*–No *Employee*–Yes, Tax free up to $100 per year; excess subject to income but not FICA or FUTA taxes.

INFORMATION AS OF MARCH, 1981. BILLS WITHOUT NUMBERS HAVE YET NOT BEEN INTRODUCED.

STATEMENT
on
Government Competition (S.J. Res. 93, H.J. Res. 294)
for submission to the
SUBCOMMITTEE ON ADVOCACY AND THE FUTURE OF SMALL BUSINESS
of the
SENATE COMMITTEE ON SMALL BUSINESS
for the
CHAMBER OF COMMERCE OF THE UNITED STATES

by
Mark Schultz*
August 27, 1981

On behalf of the more than 158,000 members of the Chamber of Commerce of the United States, I wish to express our support for S.J. Res. 93 and H.J. Res. 294, joint resolutions which reaffirm the nation's longstanding procurement policy of government reliance on the private sector for needed goods and services.

The U.S. Chamber is the largest business federation in this country, representing more than 154,000 business firms, 2,700 chambers of commerce in this country and abroad, and 1,300 trade and professional associations.

A majority of these 154,000 business firms are small businesses. In fact, more than 97 percent of our member companies employ fewer than 500 persons, almost identical to the percentage of small businesses in the total economy. More than 60 percent of our members employ fewer than 20 persons, and more than 40% have less than 10 employees.

In view of these figures, it is fair to say that the U.S. Chamber represents the interests of American business, large and small, many of whom do business with the federal government. Accordingly, we clearly have a vital stake in eliminating government competition with the private sector in providing goods and services needed by the federal government.

---

* Director, Federal Procurement Policy

Federal Procurement Policy: Reliance on the Private Sector

The U.S. Chamber recognizes the significance of any proposed changes in federal procurement policy, which now involves more than one-tenth of the federal budget. Government procurement has a major effect on the nation's businesses, their employees, government employees, and on a broader level, all American taxpayers. The policies ultimately adopted not only affect immediately the expenditure of $65 billion or more in taxpayers' money each year, but also guide the government's procurement activities for years to come.

In view of the above, it would be difficult for us to overstate the importance of close Congressional scrutiny of the total impact of any proposed changes to ensure that they do, in fact, contribute to the nation's longstanding policy of reliance on the private sector for needed goods and services.

Contracting Out vs. Government Competition

Competition with private industries by government agencies has been a source of increasing concern over the past few years.

According to recent General Accounting Office (GAO) estimates, federal employees currently perform 11,000 commercial or industrial activities that could be done by private firms. These activities cost taxpayers nearly $19 billion last year.

Consequently, private firms are finding themselves increasingly competing not only with each other, but with the government as well -- at taxpayers' expense.

For a small business already burdened by spiraling inflation, high interest rates and excessive regulations, government competition is often a crippling blow.

A 1979 Small Business Administration (SBA) Task Force Report estimated that federal in-house activities in 1977 numbered 21,130, at an annual operation cost of nearly $10 billion (a very conservative figure). According to this study, the best estimate is that at least $2 billion annually might flow directly to small business if that $10 billion were contracted-out in approximately the same proportion as other activities presently being contracted-out.

The Task Force also estimated the potential average annual savings to the taxpayer at $2.98 billion. Clearly, small business is not the only likely beneficiary if federal in-house commercial or industrial activities can be reduced.

In sum, as the business community sees it, the "business of government is to govern," not to compete with its taxpaying constituents by hiring federal employees, whose salaries and facilities are paid for by taxpaying businesses, to perform industrial or commercial activities.

The service and support industries, particularly equipment and facility maintenance, are the hardest hit by government competition. (See Appendix)

Some government agencies, having acquired surplus equipment and manpower, even sell services such as research and computer programming to other agencies.

This unnecessary growth of government competition undermines the private enterprise system and undercuts one of the nation's most valuable resources -- soundly conceived programs of scientific and technological research and development which have been vital to our economic growth, and to the welfare and security of our country.

History of Current Procurement Policy

The longstanding federal procurement policy has been, and continues to be, that the government should rely on the private sector for needed goods and services.

In 1932, the first study into the matter was made by a special committee of the House of Representatives. Numerous Congressional studies and commissions also have examined the problem in subsequent years.

However, our current procurement policy was not set forth until 1955, when the Eisenhower Administration issued a directive that the government should not provide services that put it in competition with private industry.

That policy was reaffirmed during the Johnson Administration by Circular A-76, issued by the Bureau of the Budget, predecessor of the Office of Management and Budget (OMB) (the Circular is now referred to as OMB Circular A-76).

Circular A-76 reiterated the government's general policy of reliance on the private enterprise system to supply its needs. It established the rule that goods and services were to be acquired from the private sector whenever feasible; the exception was to provide them in-house using federal employees.

Circular A-76 established new criteria for continuing or terminating in-house activity. It further provided that a government commercial or industrial activity may be authorized to provide goods or services only under certain conditions.

Advantages to Contracting Out

Circular A-76 was conceived in recognition of the major advantages of "contracting out" -- its cost-effectiveness, the flexibility it provides with regard to manpower and changing priorities, and its ability to increase technology transfers.

In most cases, the American taxpayer gets a much better deal under competitive contract than when functions are performed in-house. Procurement experts have estimated that competitive contracts can reduce costs by as much as 25 to 50 percent.

For example, according to the Office of the Secretary of Defense, for Fiscal Years '79, '80, and part of '81 DOD has conducted cost comparisons between in-house commercial activities and competitive contract performance. In 270 of these studies, contract performance was shown to be more economical and contracts were awarded, producing savings of $209 million. In the other 158 cases, and with the incentives of job competition, in-house performance was shown to be more cost-effective, reducing costs by $95 million.

Contracting out, besides being more economical, also provides government managers with a greater degree of flexibility. Contracts can be awarded, terminated, and reopened to provide needed goods and services at the lowest cost; not so with a government facility or work force. The very nature of government and bureaucracy, with the attendant civil service regulations, make reductions in force -- after a function is completed -- difficult if not impossible. While government priorities change and shift constantly, federal employees hired for one purpose remain on the government payrolls years after the project for which they were hired has been completed; not so with contracted employees.

Finally, when government research is performed by private firms, its application to civilian markets is accomplished more quickly. For example, the National Aeronautics and Space Administration's space program, which relies heavily on private sector research firms, has provided us with many useful consumer products.

It is essential that procurement policies and programs designed to further this progress in scientific knowledge and application take full advantage of the research capabilities and technical competency of private enterprise. Greater progress will be made by more fully utilizing the capabilities of private enterprise rather than by establishing or expanding government facilities in competition with them.

Implementation of Current Policy

However, as noted at the outset, over the past few years OMB Circular A-76's policy of reliance on the private sector effectively has been ignored.

Circumvention of this policy has been achieved through loose agency constructions of what is or is not a "governmental function." Under OMB Circular A-76, purely "governmental functions" are to be performed in-house. This exception to reliance on the private sector has provided agencies with "justification" for many of the activities performed by federal employees.

Threatened disruption, delays and degradation of service resulting from possible strikes by private sector unions is an often-cited reason for not contracting out important commercial or industrial functions. But, where strikes have occurred, rarely has degradation of service been experienced. Moreover, no longer can government union officials claim exemption from possible strike activity, in the wake of the threatened walk-out by postal officials and the actual strike by air traffic controllers.

Alleged abuses in the procurement system -- e.g., year-end spending, individual and organizational conflicts of interest, and sole-source contracting -- have led to calls for greater control over the so-called "beltway bandits" (i.e., consultants whose offices are located along the beltway surrounding Washington) and "invisible army of contracted employees." Unfortunately, this is a well-orchestrated movement which seeks to smear the private sector while expanding federal bureaucracy.

In fact, there is no sector of the economy with less control and accountability than government -- at all levels. Government accounting systems are oriented toward outlays and disbursements, not costs. No agency has a cost accounting system that rivals the cost accounting requirements for federal contractors. When an agency contracts for a product or service, there is a detailed accounting for all costs, in terms of the results provided. Conversely, when an agency performs a task in-house, there is control only over the number of employees and the total dollars expended -- but no control over, or accountability for, output.

Finally, critics of contracting out have made much of the large number of federal contractors and consultants. But the number of employees who may be involved in performance of federal contracts is immaterial; the fact that contract performance is more economical is the key point.

Preoccupation with the number of contract employees is irrelevant to the real issue -- economy in government. To begin with, there will never be a completely accurate account of contractors. Many are involved in providing the same product or service to private consumers; many contracts are awarded, and many others are completed each day. More significantly, most contracts are written in terms of the products or services to be provided and the cost to the government, not in terms of the number of people to be employed.

Federal Employee Union Pressure

Federal employee union pressure is most responsible for the current attitude toward contracting out.

These unions have taken a strong stance against contracts for work that could be performed by government employees. In addition, they have challenged the legality of "contract conversions", i.e., where a job previously performed by federal employees is contracted out, and have enlisted support from Members of Congress relative to agency decisions to award contracts.

The net effect of these lawsuits and protests is that agencies, understandably, are "gun shy" about awarding contracts or contract conversions.

The federal employee unions' tremendous influence has continued unabated because the business community and private sector unions have yet to exert a comparable countervailing influence.

Anti-Contracting Out Legislation

As a direct result of the federal employee unions' successful lobbying campaign, Congress over the past few years has placed moratoriums and more and more restrictions on contracting out. The Department of Defense (DOD) Appropriations Act for FY '78 contained a moratorium provision preventing contracting out of defense support functions.

In the 96th Congress, Section 502 of the DOD Authorization Act for FY '81 required detailed cost comparison studies which had to be certified by the Secretary of Defense and provided to Congress -- making

DOD's ability to convert work being done by federal employees to more cost-effective private contracts increasingly more difficult. The House version of the Act also contained a provision allowing federal employees the right to seek judicial review and relief when contract awards "adversely affected" their jobs.

Contractors also witnessed the introduction of a "federal employee relief bill" (H.R. 4717) by then-Representative Herb Harris which would have had a chilling effect on contracting out. The Harris bill was designed to prevent federal agencies from contracting out to avoid personnel ceilings. Agencies would be required to reduce their in-house personnel by the number of those contracted to perform a function. If it were found to be more cost-effective to perform a function in-house but the agency did not have the necessary personnel, the agency could request OMB to raise its personnel ceiling to accommodate the need.

Faced with the choice of losing personnel by contracting out or acquiring personnel by keeping work in-house, it is easy to predict what most agency managers would choose to do -- i.e., not contract out.

In the 97th Congress, Sections 602 and 304 of the House-passed version of FY '82 DOD Authorization (H.R. 3519) interfere with OMB Circular A-76 policies governing contracting out and conversion of DOD work to private contract. Section 602 would require military commanders to certify that a "contract conversion" would not jeopardize mobilization capabilities. Section 304 would prohibit the contracting out of an entire medical facility. Both provisions fly in the face of A-76 and would establish bad procurement precedents.

Section 10004 of this year's House budget reconciliation bill, as reported out by the House Post Office and Civil Service Committee, contained a recodification of the Harris proposal outlined above.

The Schroeder (D-Colo.) Amendment to the proposed Department of Energy (DOE) National Security authorization bill for FY '82 (H.R. 3413) would overturn a contracting out award made by DOE for security services at the Los Alamos National Laboratory in New Mexico.

Finally, the most subtle attacks on contracting out have been the constant allegations of contract abuses leveled at private consultants and a wide range of professional, research, and technical services, resulting in a variety of procurement "reform" bills.

These recent initiatives underscore the urgent need for Congressional action to reaffirm and codify the sound policy of reliance on the private sector.

Legislative Action

The Reagan Administration recently stated its position on contracting out, announcing full support for the same proven policy, i.e., reliance on the private sector whenever possible. The Administration further stated that correct and vigorous agency implementation of OMB Circular A-76 policy will give taxpayers what they deserve - economy in government.

In June, Senator S. I. Hayakawa (R-Calif.) and Representative David Dreier (R-Calif.) introduced joint resolutions to address the government competition problem.

S.J. Res. 93 in the Senate and H.J. Res. 294 in the House reaffirm and codify the time-honored, but erratically observed, policy embodied in OMB Circular A-76.

The Chamber wholeheartedly supports the Hayakawa-Dreier effort to help private contractors.

The time has come to stop taking billions of dollars of work away from businesses, large and small -- those who pay a large share of America's taxes -- and to stop giving that work to federal employees whose facilities and salaries are paid for with those tax dollars.

The U.S. Chamber appreciates this opportunity to address this important issue. I will appreciate your consideration of our views, and I respectfully request that this statement be included in the hearings' record.

APPENDIX

Where the Government Collides With Private Industry

Here is a sampling of industrial and commercial activities performed for the federal government by its own employes—

Agency and Activity	Number of Employes	Cost Per Year
Department of Energy, Washington, D.C., printing and binding	28	$ 1,249,000
U.S. Coast Guard, Governor's Island, N.Y., maintaining golf course	6	$ 45,000
Federal Aviation Administration, Oklahoma City, data-processing services	182	$ 7,172,000
Federal Aviation Administration, Washington National and Dulles International Airports, janitorial services	60	$ 1,004,000
Federal Railroad Administration, Alaska Railroad	474	$37,000,000
Department of Energy, Portland, Oreg., power-systems operation	395	$11,500,000
International Communication Agency, Washington, D.C., guard services	10	$ 209,349
Federal Trade Commission, Washington, D.C., cigarette laboratory	7	$ 200,000
Federal Trade Commission, Washington, D.C., micrographics	5	$ 131,132
Veterans Administration, Department of Memorial Affairs, Farmingdale, N.Y., gravedigging and backfilling	23	$ 512,000
Bureau of Engraving and Printing, Washington, D.C., ink manufacturing	40	$ 4,000,000
Department of Justice, Justice Management Division, Washington, D.C., chauffeur services	10	$ 277,165

Source: U.S. News & World Report